



Memorandum

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Chief Deputy Director

From : Tina Watson (signed copy on file)
Chief, Audit Services

Date : December 31 , 2007

Subject: **INTERNAL CONTROL REVIEW FOR THE PERIOD ENDING
DECEMBER 31, 2007**

File No. : IIIA.16 -1084; IIIA.15 -1083

Introduction

The mission of the Department of Rehabilitation (Department) is to work in partnership with consumers and other stakeholders to provide services and advocacy resulting in employment, independent living and equality for individuals with disabilities. To fulfill this mission, the following goals have been set:

- Increase the quality and quantity of employment outcomes
- Increase the effectiveness and efficiency of vocational rehabilitation services delivery.
- Improve Department infrastructure.
- Improve work environment.
- Increase equality for persons with disabilities through systems change.

We have reviewed the Department's internal controls as of November 14, 2007 with the primary focus on internal accounting and administrative controls within the Business Enterprises Program (BEP) for the Blind in the areas of:

- BEP Vendor Monthly Operating Reports (MORs/Profit & Loss Statements)

- Set-Aside Fees & Other Monies Owed
- Partnering Agreements (Teaming Partners) & Subcontracting
- BEP Vendor Agreements
- Vending Machine Commission Contracts

We also performed a review of the Department's internal controls in the following areas:

- Abolished and re-established positions for Fiscal Year 2005/06 as required by Government Code §12439.
- Follow-up review on the 2005 Internal Control Review findings and recommendations in the areas of: Information Technology Controls, Bank Drafts, and Case Service/Cooperative Program Contracts. Follow-up was limited to actions completed as of the 1-year corrective plan.
- A review of the Department's collection function for accounts receivable and revolving fund advances as required by Department of Finance (DOF) Audit Memo 06-01.

Because governments are susceptible to fraud, waste, and abuse, the Financial Integrity and State Manager's Accountability (FISMA) Act, Government Code §13400-13407, was enacted to inhibit waste of resources and create savings. FISMA states that management is responsible for the establishment and maintenance of internal accounting and administrative controls. Internal accounting controls comprise the methods and procedures directly associated with safeguarding assets and assuring the reliability of accounting data. Internal administrative (program) controls comprise the methods and procedures that address operational efficiency and adherence to management's policies.

These controls are defined as a process to provide reasonable assurance regarding the achievement of objectives in the following categories:

- ✓ Safeguarding of Assets
- ✓ Reliability of Financial Reporting
- ✓ Effectiveness and Efficiency of Operations
- ✓ Compliance with Applicable Laws and Regulations
- ✓ Adherence to Office Policies and Procedures

This definition includes five interrelated components:

Control Environment sets the tone of an organization, influencing the control consciousness of its staff. It is the foundation for all other internal control components, providing discipline and structure.

Risk Assessment is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.

Control Activities are the policies and procedures that help ensure management directives are carried out.

Information and Communication are the identification, capture, and exchange of information in a form and time frame that enable staff to carry out their responsibilities.

Monitoring is the process that assesses the quality of internal control performance over time.

Symptoms of control deficiencies, when identified, may apply to the Department as a whole or to individual units or activities, and may include:

- Policy and procedural or operational manuals are either not currently maintained or are nonexistent.
- Line of organizational authority and responsibility are not clearly communicated or are nonexistent.
- Financial and operational reporting is not timely and not used as an effective management tool.
- Line supervisors ignore or do not adequately monitor control compliance.
- No procedures are established to assure that controls in all areas of operation are evaluated on a reasonable and timely basis.
- Internal control weaknesses detected are not acted upon in a timely manner.
- Controls bear little relationship to organizational exposure to risk of loss or resources.

Audit Scope

We completed a review and evaluation of the Department's accounting and administrative controls as of November 14, 2007. We conducted our review in accordance with the International Standards for the Professional Practice of Internal Auditing (ISPPA) published by the Institute of Internal Auditors, as required by Government Code §13886.5, and included audit tests we considered necessary in determining that such controls are in place and operative. Fieldwork for the BEP review and the limited review of the 2005 Internal Control Review actions completed was conducted during the period of March 2007 through November 2007. Fieldwork for the review of the Department's collection function was conducted during the period of September 2006 through April 2007.

Review of BEP

Audit Services obtained and reviewed the following information and documentation in relation to our review of BEP:

- A survey and interviews with BEP line and management staff
- BEP Procedures Manual and other BEP rules, regulations, and procedures
- BEP Strategic Plan, Revised January 2007
- Other States' procedures for evaluating and monitoring the BEP, when available
- Partnering Agreements (Teaming Partners) and Subcontracts
- Monthly Operating Reports and Instructions (DR 478/DR 478A Rev. 2/00); and Set-Aside Fee Schedule
- BEP Location and Vendor files and the information contained therein
- BEP Profit and Loss Statewide Averages (DR 478 Guidelines/ BEF013AA)
- Duty Statements
- Missing MOR Query (BEF509AA)
- Delinquent fee information including adjustment sheets, corrected MORs, accounts receivable listing, and payment plans
- BEP Vendor Agreements (DR 469)
- Vending Machine Commission Contracts

Our review was conducted internally and did not include a survey or interviews with BEP vendors, teaming partners/subcontractors, or the California Vendors' Policy Committee (CVPC).

Limited Review of 2005 Internal Control Findings

Audit Services conducted a limited review of the 2005 Internal Control Review deficiencies. The review was limited to verification of completed actions reported in the 1-year corrective plan submitted to Audit Services on January 22, 2007.

Review of the Department's Collection Function

Audit Services completed a review of the Department's collection procedures for accounts receivable and revolving fund advances as required by DOF Audit Memo 06-01, Management and Internal Audit Responsibilities for Collecting Accounts Receivable, dated May 2006. In accordance with Audit Memo 06-01, we reviewed controls in place as of August 2006 to determine whether accounts receivable are established timely for amounts due; and that collection efforts for accounts receivable and revolving fund advances are timely.

Review Opinion

In reviewing the Department's internal control, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls in certain areas. A material weakness is a condition that precludes the Department's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. We believe that none of the reportable conditions is a material weakness. The reportable conditions are described in detail in the findings and recommendations section of this report.

Our review and evaluation found the following:

- Significant control deficiencies exist regarding administration of the Business Enterprises Program for the Blind (BEP).
- Corrective actions completed to resolve the deficiencies reported in the 2005 Internal Control Review were verified; however additional improvements can be made.
- The Department's collection of revolving fund advances and accounts receivable could be improved.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls change over time. Specific

limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to: resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all these limitations would not be cost effective; moreover, an audit may not always detect these limitations.

Required Reports on Corrective Action

In accordance with Government Code §13405 (c), a plan and schedule for correcting the control deficiencies identified in this report must be submitted to the Director of Finance within 30 days of report submission to the Agency Secretary. The plan must be updated and submitted every six months until all corrective actions are completed.

**DEPARTMENT OF REHABILITATION
2007 Internal Control Review**

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CHAPTER 1 : POOR MANAGEMENT PRACTICES JEOPARDIZE THE INTEGRITY OF THE BUSINESS ENTERPRISES PROGRAM FOR THE BLIND

The Department administers the BEP in accordance with the federal Randolph-Sheppard Act, the California Welfare and Institutions Code, and the California Code of Regulations (CCR). The purpose of the program is to provide blind persons with remunerative employment, enlarge the economic opportunities of the blind, and to stimulate the blind to greater efforts in striving to enable qualified blind persons to operate their own food-service businesses, including cafeterias, snack bars, wet and dry vending stands, and vending machines. As of November 2007, there were 152 active BEP vendors (vendors) participating in the program and 170 facility numbers comprised of 385 locations. BEP staffing includes 7 Support Staff, 4 Analysts, 1 Training Officer, 11 BECs, 2 SBECs, an Assistant Program Manager, and a Program Manager (vacant as of September 2007).

BEP's mission is to provide profitable, productive, and independent career opportunities for blind and visually impaired individuals. BEP provides training in basic business practices, current standards of food service provision, customer service, and financial responsibility. BEP is also responsible for development of new facilities, technical assistance to vendors, and funding for new and existing facilities.

Findings in this report identify areas where administration and oversight can be improved. Revisions to procedures and regulations may be needed and should be considered where appropriate and in consultation with Legal Affairs, and the CVPC where appropriate.

FINDING 1 INSUFFICIENT MOR INSTRUCTIONS

Condition:

The current MOR Instructions (DR478A Rev. 02/00) lack sufficient information and detail to assist vendors in accurately completing the MOR (DR478 Rev. 02/00). Lack of sufficient instructions may result in inaccurate reporting of operations including sales and expenses, set-aside fees, and insurance payments on the MORs; and require unnecessary MOR adjustments to be made by the vendor and the Department.

The purpose of the MOR and Instructions is to provide appropriate information to the Department to evaluate vendor operations; develop

reports required by federal and state governments; and establish fee, liability insurance, and workers compensation insurance payments. The MOR includes information such as gross receipts, net sales, cost of goods sold, operating expenses, other income, set-aside fee, and liability and workers compensation insurance.

BEP management explained that when revising the MOR and Instructions in 2000, the intent was to streamline the documents since some of the information was already included in regulations; the assumption was that vendors are familiar with the process; the forms needed to be in a larger font size; and there was a need to not change the number of pages for the MOR. However, these do not appear to be valid reasons for not providing vendors with a more comprehensive set of instructions.

We requested information from 5 other states regarding monthly operating reports and instructions. We found that Nevada and Arizona have a more comprehensive report; and although Nevada has the most comprehensive set of instructions, Texas and Arizona also had some good information in their instructions that could be considered by BEP. In addition, all three states required some form of documentation to be submitted by the vendor with the MOR ranging from cash register tapes (z-tapes), monthly inventories to determine cost of goods sold, general ledger, etc.

- ***Gross receipts (line #1)***

The Instructions do not specifically identify what shall be included in gross receipts. BEP staff reported that vendors often have questions about what is included in gross receipts and where catering income should be reported. The Instructions from April 1992 gave more specifics as to what information was to be included in gross receipts, and actually broke out receipts between operations, catering/other, and vending machines.

- ***Accounting Records/Subject to Audit***

The Instructions do not include language regarding required accounting records and records retention, and that vendors are subject to review and audit by the Department, BEP, Rehabilitation Services Administration (RSA), and others as appropriate; and actions that will be taken by BEP when vendors do not comply.

Although Department regulations contain information about required records, record retention, and audit requirements it would be more effective and accessible to vendors and their bookkeepers to have a comprehensive, all-inclusive set of Instructions for completion of the MOR.

- ***Workers' Compensation And Liability Insurance - Rates and Prepays***

The Instructions do not provide contact information to vendors on where to obtain the current worker's compensation and liability insurance rates when needed. As such, excessive accounting adjustments are required by the Department's Accounting Section in this area. This deficiency was confirmed with BEP staff and evidenced from our review of the accounting adjustments being made to the MORs.

For a sample of 20 locations reviewed for the 2006 calendar year period, we found 56 MORs required adjustments to the liability insurance and 22 MORs required adjustments to the workers' compensation insurance. Additionally, two vendors in our sample required adjustments for the entire 12 months as a result of using incorrect rates.

Although the rate information is sent out by the Department of General Services (DGS) Office of Risk Insurance Management directly to the vendors and the rates are available on the CVPC website, the Department continues to receive MORs with insurance errors.

In addition, in regards to first time vendors to the program, there is confusion by vendors on how to report the prepaid (Department authorized and paid) insurance amounts on the MOR; and instances where the prepaid insurance amounts authorized are insufficient or not authorized timely resulting in continual adjustments to the MOR. This was noted as a concern by both BEP and Accounting staff.

- ***Penalties/Actions for Non-Compliance***

Although the Instructions discuss that a late payment penalty will be assessed when the MOR and set-aside fee is not submitted by the due date, the Instructions do not specifically address other actions to be taken when vendors fail to submit MORs; or submit MORs late on a continual basis. Although some language is included in regulations, the Instructions should state the requirements and actions for non-compliance. This will assist in holding vendors accountable for MOR submission and inform them of the actions that will be taken when non-compliance occurs.

- ***No Reference to Law or Regulations***

The Instructions do not contain references to the laws, rules, and regulations that vendors must adhere to.

- ***Closing Merchandise Inventory/Cost of Goods Sold***

The Instructions, and BEP regulations, require that the closing inventory must be actual at least twice annually, June 30 and December 31. However, the Instructions do not explain how vendor's are to report closing inventory for the other months in which monthly inventories are not required, nor performed; and do not indicate what documentation must be maintained to support the amounts reported. For the most part, this figure is a calculated figure in conjunction with the cost of goods sold and is not based on actual inventory remaining. In addition, we found that although the BEP Trainer explained that he trains the vendors on monthly inventory practices, BEP does not currently require vendors to perform monthly merchandise inventories. Further, regulations allow for additional inventories to be performed.

Our review of other states found that some states do require monthly inventories be performed. BEP may want to consider requiring monthly inventories be performed so that the MORs reflect the actual ending inventory and a more accurate reporting of net income, and to assist vendors with inventory control/shrinkage. Closing inventory and cost of goods sold directly affect net income which in turn affects the set-aside fee.

Criteria:

BEP is responsible for ensuring the proper administration of the program. As such, BEP must ensure that MORs are completed accurately and that vendors are provided adequate information to carry out their responsibilities; and that regulations, requirements, and procedures are enforced and consistently applied to maintain the integrity of the program.

Title 9, CCR §7220 (k) states that the vendor shall take and report the physical inventory of the merchandise and supplies twice annually for the periods ending June 30 and December 31 and at such other times as the BEP may require.

RECOMMENDATION:

BEP, in conjunction with the CVPC and the BEP Trainer, revise the Instructions to provide for a more accurate and comprehensive set of instructions to vendors considering the issues identified in this report and any other areas deemed insufficient. We recommend that BEP, as part of this process, review other States' instructions for ideas on where further improvements can be made. In addition, that changes to the MOR, where appropriate, be considered to improve reporting of operations.

BEP consider placing the liability and workers compensation insurance rates on the Department website so that vendors can readily access the information. In addition, the Instructions should provide information on the various sources where a vendor can obtain the rate information (Department website, CVPC website, and phone number to call).

BEP, in conjunction with the CVPC, review the MOR and Instructions to identify whether improvements can be made to clarify and ensure accuracy of reporting of the prepaid workers compensation and liability insurance. In addition, we recommend that the BEC, the vendor, and the Rehabilitation Counselor for the Blind (RCB) work together to ensure the insurance payments are authorized timely and for the proper amount; to assist the vendor in accurately reporting the prepaid insurance on the MORs; and to monitor the funds remaining to ensure accuracy of reporting.

BEP involve appropriate Department sections such as the Accounting Section and Information Services Section in these efforts as changes to the MOR will impact these areas. Timely involvement will ensure a successful rollout of any changes.

FINDING 2 LACK OF BEP ENFORCEMENT OF REGULATIONS, REQUIREMENTS, AND PROCEDURES

Condition:

As evidenced by the findings identified in this report, and as confirmed through surveys and discussions with BEP staff, there is lack of support and enforcement by BEP management of BEP regulations, requirements, and procedures. In fact, BEP staff reported that lack of action and enforcement by BEP is the main contributing factor why vendors are not complying with submission of MORs and set-aside fees. Lack of support and enforcement, including inconsistent application of requirements, jeopardizes the integrity of the program. In addition, it makes it difficult for BEP staff to perform their duties, and to enforce and ensure consistent and accurate reporting of operations and resulting set-aside fees.

As an example, BEP staff expressed concerns about the honest and accurate reporting of financial data on the MORs. They indicated that audits alone are not enough to create assurance and ensure accuracy of reporting by vendors on the MORs since audits are infrequent, with at most one to two vendor audits a year. BEP staff further explained that on past occasions when attempts were made to obtain accounting records from vendors for the purpose of reviewing the MORs for accuracy, the vendors refused to provide

such records and stated to BEP staff that they had no business or rights to request such information. Such statements are incorrect as regulations require vendors to provide records to Department staff upon request. Regulations also allow the suspension or termination of a vendor's license for not providing such records.

BEP staff stated that these issues had been brought to management's attention on several occasions; however, resolution from management was not forthcoming. As a result, BEP staff reported that they are hesitant to request records for review because they do not believe management will support and enforce their efforts, nor the regulations.

As another example, BEP staff reported that there is no support by management when it comes to taking action against vendors who are not complying with regulations. BEP staff indicated that they have been sending letters of notification of missing MORs to vendors; however, vendors know that the penalties and actions/consequences have been minimal. Further, BEP staff reported that past history has shown that BEP has been unable to take decisive action against vendors and ensure the action is carried out.

Although regulations and the BEP Procedures Manual (1993) exist, consistent application of the policies and procedures does not always occur. Although we recognize that the regulations are in the process of being revised and updated, and subsequently the BEP Procedures Manual, BEP must still utilize and enforce existing regulations and procedures to ensure consistency and to assist BEP staff in performance of their duties.

It is important to note that the BEP Strategic Plan, Revised January 2007, includes objectives to ensure that vendors submit monthly financial reports accurately and timely and that fees are paid promptly. Performance measures include that MORs will be reviewed each month by the BEC responsible for the facility and follow-up on specific issues within 10 days after posted to delinquent list. However, it is unclear whether the strategic plan has been discussed with BEP staff. In addition, the performance measures and key strategies included areas about conducting field audits; however, this was not discussed with the Chief of Audit Services.

Criteria:

BEP is responsible for ensuring the proper administration of the program. As such, BEP must ensure that regulations, requirements, and procedures are enforced and consistently applied to maintain the integrity of the program.

Title 9, CCR, §7220 (j) states that the vendor shall maintain required records on the operation of the facility for the current year plus the three preceding years. Upon written request, books of accurate account and records pertaining to a vending facility operation shall be made available for examination and audit by the Department at any reasonable time and place.

Title 9, CCR, §7220 (b) states that the vendor shall cooperate with BEP in connection with BEP's responsibilities. Title 9, CCR, §7213.2 (i) and (l) states that failure to pay set-aside charges, scheduled loan repayments or penalty charge on delinquent set-aside charges and/or scheduled loan repayments for more than 90 days; and failure to provide records or financial reports requested by BEP are grounds for termination or suspension of the vendor's license.

RECOMMENDATION:

BEP ensure regulations, procedures, and processes are in place and enforced; and that training is provided to all BEP staff to ensure understanding and provide for consistent application to all vendors.

BEP properly administer the program by taking immediate action to address non-compliance by vendors. BEP consider revising regulations to increase the penalty for late or non-submission of MORs and fees.

BEP ensure staff are provided appropriate support when vendors are not complying with BEP staff inquires for records for review and other areas of noncompliance. Vendors shall be notified in writing of the actions for noncompliance and BEP must follow through with the action(s) when vendors do not comply.

BEP update the BEP Procedures Manual to reflect current practices and any revisions and updates to regulations so that the manual can be used by BEP staff in the performance of their duties.

**FINDING 3 LACK OF REVIEW AND MONITORING OF MORs AND
VENDOR OPERATIONS**

Condition:

BEP is not adequately reviewing and monitoring MORs submitted by the vendors. As a result, BEP has no assurance that the revenue and expenditure data reported by the vendors is accurate. In fact, potential concerns regarding operations and inaccurate reporting of financial data

may go uncorrected for some time which directly impacts income to the vendor, set-aside fees due to the program, and reporting of information to the Rehabilitation Services Administration (RSA).

In regards to deficiencies with the MORs, BEP staff indicated that issues are discussed verbally with the vendor. However, without written documentation by BEP of the deficiencies and the discussion with the vendor to address the issues, BEP has no assurance that BECs have communicated with the vendors and are providing adequate consulting and recommendations for changes or improvement to maximize the vendor's operation and ensure compliance with procedures and regulations. In addition, we found that MORs are not always maintained in BEP files. As such, we question how staff are adequately monitoring vendor operations.

The BEC and SBEC duty statements and the BEP Procedures Manual outline the staff duties related to the MORs and consultation with the vendor. The MOR Instructions state that a review of the MOR will be completed by BEP staff. Audit Services has provided two MOR review trainings to BEP staff, one in 1999 and another in 2004. However, deficiencies still exist in BEP's review and monitoring of MORs.

It is important to note that the BEP Strategic Plan, Revised January 2007, includes objectives and strategies to clarify, strengthen, and support the role of the BECs which includes a review and update of duties, training, and continuing education; and plans to automate the MORs and ensure that vendors submit MORs accurately and timely.

- ***Missing Vendor Signatures/Dates***

For 167 MORs reviewed, seven were missing vendor signatures and 27 were not dated by the vendor. However, no comments were documented on the MOR by either the BEC or SBEC as part of their required review process. BEP staff could not explain why they had signed the MORs when the vendor's signature and/or date was missing and thought it was likely oversight by BECs/SBECs.

The vendor's signature on the MOR is required by the Instructions and signifies the report is a correct statement of the operation of the vendor's facility and contains only valid financial information for the location. The vendor signature on the MOR holds the vendor accountable for the correctness of the financial information reported and submitted. An unsigned or incomplete report is to be returned to the vendor.

- ***MORs Not Always Signed/Dated by BEP Program Staff***

For 167 MORs reviewed, 34 (20%) were not signed and 38 (23%) were not dated by the BECs; and 82 (49%) were not signed and 86 (51%) were not dated by the SBECs. Therefore, we could not determine whether the BECs/SBECs reviewed the MORs as required.

- ***BEC Analysis and Evaluation of MOR Insufficient***

Based on our review of MORs, BECs are not adequately analyzing and evaluating the MORs; nor adequately reviewing the areas of gross receipts, net sales, cost of goods, payroll expense, other operating expenses, other income, net proceeds, fee to vending program and payment due using the BEP statewide averages (BEF013AA). In fact, other than a signature, there is very little evidence of MOR reviews by the BECs. Of 167 MORs reviewed, only 13 had a BEC comment noted, but the comments were very minimal such as COGS too high, labor too high, etc. Further, of the 13 with noted comments, we found no evidence of follow-up with the vendor by the BEC.

For a sample of 20 vendor locations reviewed for calendar year 2006, we identified the following:

- ✓ For 12 of 20 (60%) locations, gross receipts/net sales were at least 30% below the statewide averages for the type of BEP facility. However, no comment was noted on the MOR by the BEC or SBEC.
- ✓ For 12 of 20 (60%) locations, the cost of goods sold was averaging 8% to 36% higher than the statewide averages for the type of BEP facility. Further, one location's cost of goods sold was as much as 83.5% of its gross income. However, no comment was noted on the MOR by the BEC or SBEC.
- ✓ One of the vending machine location's payroll expenses was averaging 22% higher than the statewide averages for the same BEP location type. Also, two of the wet vending stand's payroll expenses were averaging 12% and 13% higher than the statewide averages for the same BEP location type. However, no comment was noted on the MOR by the BEC or SBEC.
- ✓ For 3 of 20 locations, operating expenses were 8% to 13% higher than the statewide averages for the same BEP location type. However, no comment was noted on the MOR by the BEC or SBEC.

- ✓ For 15 of 20 locations, net proceeds were at least 6% below the statewide averages for the same BEP location type. Further, five of the locations reported negative average net proceeds as much as 9.3%. However, no comment was noted on the MOR by the BEC or SBEC.
- ✓ In addition, for the 20 locations reviewed for calendar year 2006, there were a total of 240 MORs submitted by the vendors. The Department's Accounting Section made a total of 56 adjustments to Liability Insurance; 22 adjustments to Workers Compensation Insurance; and 16 adjustments to the Fees on the MORs. The Accounting Section forwarded a copy of each adjustment to the BECs in accordance with procedure. Two vendors had adjustments for all 12 months, which represents more than 44% of the adjustments. However, no comments were noted on the MORs by the BECs or SBECs.

When questioned about the MOR reviews, BEP staff stated that they review the MORs prior to signing off on them. Most BECs stated that they do not document the review; instead, they verbally communicate the deficiencies to the vendors either in person or over the phone. SBECs stated that they confirm with the BECs that they have performed their reviewing/consulting obligation prior to signing the MOR. However, as BEP asserts most communications were done verbally, no documentation exists to support these statements.

We found other States such as Arizona, Tennessee, and Florida use gross and/or net profit percentages based on the reported operations as a standard of performance measure for vendors and hold vendors accountable for maintaining their operation at or above the minimum standards, often through inclusion of the standards in the vendor operating agreement and/or as part of the facility review.

- ***Lack of System For Receipt, Review, and Retention of MORs***

Although we found that the BEP Procedures Manual included procedures for receipt, review and retention of MORs, BEP reported that it has no existing tracking system for recording receipt of MORs from the Accounting Section by the BEP Field Offices.

We found that only 7 of 167 MORs reviewed had a date stamp by BEP field offices. Without an adequate system in place for tracking and review of the MORs, BEP is not able to assure that all MORs are being received and reviewed by BECs and SBECs as required. The Field

Offices' clerical staff stated that they were not aware nor instructed to log and date stamp the MORs upon receipt; and that BEP staff have never asked for such a log.

The BEP Field Offices' location files did not contain all of the MORs submitted by the vendors. Specifically, more than 30% of the MORs are missing from the 20 location files reviewed.

Criteria:

BEP is responsible for ensuring the proper administration of the program. As such, BEP must ensure that regulations, requirements, and procedures are enforced and consistently applied to maintain the integrity of the program.

The MOR Instructions state the vendor must sign name and date the report; the vendor's signature on the report signifies the report and attachments are a correct statement of the operation of the vendor's facility and contains only valid financial information for the location. Willful falsification of the report is legal cause for revocation of the vendor's license. The vendor is responsible for the completeness, accuracy, and submission of the report with an acceptable check or money order. An unsigned or incomplete report will be returned to the vendor.

The duty statement for the BEC stated that 10% of essential duties as a BEC is to personally review all vendor MORs and invoices and will consult with the vendor, the accounting section, and the section's MOR Monitoring Unit to resolve problems and disputes arising from the contents of the MOR. In addition, the BEP Procedures Manual 11.1 states BECs shall review all MORs within 15 working days of the date received in the field office as follows:

- Compare MOR with the Minimum Guidelines (statewide averages); and verify compliance with the MOR Instructions.
- Evaluate overall factors on MOR and review the areas of gross receipts, net sales, cost of goods, payroll expense, other operating expenses, other income, net proceeds, fee to vending program and payment due.
- Sign, date and note whether the MOR is: Accepted, Conditionally Accepted with areas of concern identified and justified, or Unacceptable – a review and discussion with the vendor, identifying deficiencies and resolutions must be conducted.
- Forward MOR to SBEC for review.

The SBEC will review all MORs for the following:

- MOR completely filled out and signed; MOR meets minimum guidelines; whether net profit meets or exceeds BEP regulations.
- Any unusual discrepancies in the MOR which have not been explained; evaluate each MOR to determine if questionable or misleading information is on the MOR.
- What recommendation has the BEC made? Is the recommendation valid? Instruct and inform the BEC of areas overlooked or additional action necessary.
- Use the instructions for the BEC review, and do a complete review of at least one MOR per BEC per month to ensure that the BEC is performing his/her job adequately.
- Once the review is complete forward the MOR to the field office clerical staff for filing.

BEP Procedures Manual 11.1 states that the BEP Field Offices' Clerical staff must process incoming MORs on the day received. Record all received MORs in the logbook and forward to the appropriate BEC for review. The process of receiving, stamping, logging and forwarding MORs should be completed within three working days. File all MORs in the appropriate location file. MORs are to be filed in chronological order, with the most current in front.

RECOMMENDATION:

BEP adequately review, monitor, and track the MORs submitted to ensure the revenue and expenditure data reported by the vendor is accurate, that appropriate actions and corrections are made in a timely manner, and information reported to RSA is accurate. This shall include procedures to ensure that:

- Vendor's have signed/dated the MOR.
- BECs have reviewed and evidenced their review by signing and dating the MOR.
- BECs note deficiencies and corrective actions needed by the vendor on the MOR, and notify the vendors in writing of the needed corrective actions.
- Deficiencies are corrected in a timely manner. Written documentation must be maintained in the location file documenting the deficiencies and how and when they were corrected.

In regards to the SBEC reviews, BEP may want to reconsider the requirement that SBECs review all MORs on a monthly basis. It may be more efficient and effective for SBECs to implement a review timeline in which MORs are reviewed for a set number of locations each quarter with the goal of having reviewed MORs for all locations over the course of a year. Utilizing a quarterly review system, the SBEC could perform a better evaluation of the vendor operations and review the MORs for the quarter, and over the last year, for comparative purposes. This will also allow the SBEC to evaluate whether the BECs are performing their duties adequately.

BEP implement a system, in compliance with the BEP Procedures Manual, to adequately track receipt of the MORs, to ensure BEP Field Offices date stamp the MORs when received from Accounting Section, and ensure that all MORs are filed in the appropriate location file after the reviews are completed.

FINDING 4 QUARTERLY LOCATION REVIEWS ARE NOT ADEQUATELY TRACKED AND CONDUCTED

Condition:

BEP is not adequately conducting and tracking quarterly location reviews to ensure BEP facilities are operated at an optimum level. Without quarterly location reviews, the vendors will not get appropriate consulting and feedback regarding recommendations for changes to improve the vendors' operation and income. Improved income can result in increased set-aside fees.

The Bureau of State Audits (BSA) in its September 2002 report (#2002-031) identified that location reviews were not being performed, no system was in place to notify BECs when reviews are past due, that most vendors receive informal feedback through conversations with the BECs, and that informal discussions do not necessarily address each area covered by reviews nor result in the proper documentation of locations' recurring problems.

The purpose of the location review is for the vendor and BEC to ensure the location is being operated at its optimum level, and includes developing a plan of corrective action for areas that are rated improvement needed. The review should take a minimum of three hours and each location is to be reviewed a minimum of once every three months by the BEC. The location review evaluates the operation in the areas of general appearance, merchandising, customer service, equipment care and maintenance, safety, and financial potential.

It is important to note that the BEP Strategic Plan, Revised January 2007, includes an objective to implement a system for evaluating the performance of vendors including performing and tracking of the quarterly facility (location) reviews.

- ***BEP is not Adequately Tracking Location Reviews***

Only 2 of 5 BECs in the Southern Region have all of their location reviews tracked for calendar year 2006. The Program Manager explained that due to human error in mid-2006, some of the data on the tracking log for the Southern Region was lost. For the 5 BECs in the Northern Region, only two BECs started to track their assigned location reviews at the beginning of the FY 06/07. The Northern Region SBEC stated that he does not know why there is no data for the other three BECs.

In addition, based on our review of the sample location files and the location review tracking logs, we found discrepancies between the location files and the tracking logs. Specifically, the tracking logs indicated location reviews were done, however, we were unable to locate all reviews in the location files. BEP staff were unable to adequately explain the discrepancies.

We reviewed a sample of 20 BEP location files and the files only contained a total of 23 (29%) completed location reviews of the required 80 in 2006. Six (30%) locations only had one review completed; and seven (35%) locations had no reviews conducted. In addition, for the 23 location reviews completed by the BECs, 10 were not reviewed and signed by the SBEC as required by procedures.

BEP staff reported there is very little training by the supervisors (SBECs) on performing the location reviews. Refer to **Finding 6** for more details regarding BEP staff lack of understanding and guidance in this area.

- ***Inadequate Completion of the Location Reviews***

For 18 of 23 location reviews, the BEC marked "Yes" for the location is realizing full financial potential and the MOR (DR478) meets averages. However, based on our review of the MORs submitted by vendors in 2006 for the 20 sample locations:

- ✓ 12 of the locations' average gross receipts did not meet the statewide averages for the same type of BEP facility; and the average cost of goods sold were 8 to 30% higher than the statewide averages for the same type of BEP facility;

- ✓ 3 of the 20 sample locations' average operating expenses were 8 to 13% higher than the statewide average for the same BEP facility type;
- ✓ 15 of the 20 sample locations' average net proceeds were at least 6% below the statewide averages for the same BEP facility type; and
- ✓ 5 of the locations had reported negative average net proceeds as much as (-9.3%).

In addition, six of 23 location reviews received perfect scores (no issues noted) and the BEC reported that the location is realizing full financial potential, and the MOR (DR478) meets averages. However, those locations' average net proceeds were below the statewide averages, and COGS averaged 8 to 21% higher than the statewide averages for the same facility types.

BECs stated that they do not always use the statewide averages because every location is unique; and that at times they have used their experiences in the business to complete the task. The BECs also explained that the corrective action usually is communicated verbally to the vendors and not provided in writing.

- ***Lack of Follow-Up with Vendors to Address Areas of Concern Noted on the Location Reviews***

For 13 of 23 location reviews, we found no evidence of a corrective action plan for items marked "No" on the location review. Further, we found one location had three location reviews on file in which all three were checked "No" for the same item; however we found no evidence that a corrective action plan was developed with the vendor.

Some reviews identified a corrective action plan on the location review; however the corrective plan was not sufficient as it simply restated the issue and did not address how the vendor was going to correct the deficiencies.

Most BECs stated that they verbally communicate with the vendors regarding any corrective action on the issues identified during the location reviews. Some BECs stated that many of the issues are easy to fix, and it was fixed on the spot. They did not think it was necessary to document this information.

Our review of Florida's Facility Visitation Report found that it included the time the consultant's time in and time out; ratings of good/fair/poor for each rating category; an area for operator (vendor) comments; an

area indicating whether follow up action was required; the date of follow-up; and also included the facilities business averages. The BEP location review form does not include these areas and BEP should consider revising the location form to include these areas and other areas that would make this review more effective. BEP may want to survey more State's in this area to assist in improving its location review process.

- **Location Review Ratings Unclear**

The location reviews use an overall score (possible points vary based on the type of location). The overall ratings are Very Good, Standard, and Improvement Needed (point ranges vary based on type of location). However, the purpose of this rating system is unclear. A vendor could have been marked "no" in the areas of personal hygiene, safety, and financial potential, but still be rated as Very Good in the overall scoring.

Criteria:

The BEP Procedures Manual 11.3 states the purpose of the Location Review/Evaluation is for the vendor and BEC to ensure that the location is being operated at its optimum level, and includes developing a plan of corrective action for the areas that are rated improvement needed. Each location is to be reviewed a minimum of once every three months. The BEC shall read and discuss the review with the vendor after the completion of the review. If any of the questions do not meet expectations, the BEC shall discuss and work with the vendor on a Corrective Action Plan for Items marked "No" and obtain the vendor's signature. The BEC shall sign the review, provide a copy to the vendor, and forward the original signed copy to the SBEC for his/her review. The review shall then be filed in the Central Office and Field vendor file.

In addition, staff shall use the BEP Profit and Loss Statewide Averages (BEF013AA) when conducting a location review to ensure that the location is being operated at its optimum level, especially for the financial element of the review.

RECOMMENDATION:

BEP take the following steps to correct the location review deficiencies:

- Implement a system to adequately track location reviews due and completed to ensure reviews are being performed.
- Review the current location review form(s), in consultation with the CVPC, to determine whether revisions can be made to improve the

evaluation process including the overall rating and overall score. Make needed changes.

- Train BECs on the location review process to ensure understanding of the objective and intent of location reviews; and provide for consistency in the review process. Further, a system should be in place to provide training to new BECs in BEP policies and procedures.
- Conduct location reviews at the required intervals.
- Adequately identify corrective actions based on the location review and adequately document the deficiencies and the corrective actions required on the location review form.
- Discuss the results of the review with the vendor and ensure vendor signs the location review form. Provide a copy to the vendor. After form is signed by BEC/SBEC, retain in appropriate BEP file.
- Follow up with vendor to ensure deficiencies are corrected. Document dates deficiencies are corrected and place in location review file.
- Consider including location review requirements in regulations.

FINDING 5 ANNUAL VENDOR APPRAISALS ARE NOT CONDUCTED

Condition:

BEP is not conducting annual vendor appraisals (DR 457) to ensure BEP facilities are operated at an optimum level. The purpose of the vendor appraisal is to rate the performance of a vendor in five critical areas: public relations, merchandising, supervision of employees, financial responsibility, and sanitation and safety. It also includes an area to document any training attended by the vendor. In addition, prior to discontinuing use of the vendor appraisal, BEP also used the appraisals in its vendor selection process.

BEP staff explained that they were told by BEP Administration, approximately six or seven years ago, that vendor appraisals were no longer required. However, BEP was unable to provide any formal documentation or instruction regarding the discontinuance of the vendor appraisal process by management. The Program Manager stated that the program had decided to discontinue the vendor appraisal process and, although he was not involved in making the decision, his understanding was that it was discontinued because many complaints were received from vendors that the appraisal was not fair and objective; and was utilized during the vendor selection process. Further, in previous discussions with BEP Administration, it was explained that the appraisals were completed to report a 'standard'

rating for all vendors regardless of actual performance. BEP decided to discontinue the process at the request of the CVPC.

Without appraisals, BEP is not maximizing opportunities to offer consulting services to vendors and BECs cannot ensure that they promptly address the aspects of vendors' performance that negatively affect their profitability, which also could have a negative impact on set-aside fees due to the program. Further, it eliminates a source of good information for the BEP to use during the vendor selection process. Appraisals, if objective, can be useful in improving vendor performance.

Criteria:

BEP Procedures Manual 11.2 states that the Vendor Appraisal (DR457) is a document used by the BEC in rating the performance of a vendor in five critical areas within a BEP location: public relation, merchandising, supervision of employees, financial responsibility, and sanitation and safety. In addition, the Department uses information on the appraisals in its selection process when awarding facilities to vendors. The vendor appraisal must be updated at least once a year.

RECOMMENDATION:

BEP, in consultation with the CVPC, review the Vendor Appraisal form to determine its value to the vendor and the program. Consider making changes to provide for a more useful and effective evaluation. Further, if the use of the Vendor Appraisal is reinstituted, BEP shall train BECs/SBECs on its use; track due dates and completion; and maintain copies in the vendor file. BEP should also consider adding the vendor appraisal requirements in to regulations if it is going to be used to evaluate vendor performance.

**FINDING 6 LACK OF UNDERSTANDING AND GUIDANCE IN
PERFORMANCE OF BEC AND SBEC DUTIES**

Condition:

Based on the findings in this report and input from BEP staff, we observed that BECs and SBECs do not receive sufficient guidance in the performance of their duties and, as a result, lack a complete understanding of their essential duties and the amount of the time that should be spent performing various functions.

The Bureau of State Audits (BSA) in its August 1997 report (#97502), Poor Management Practices Limit the Effectiveness of the Business Enterprise Program for the Blind, identified that BEP needs to provide sufficient

guidance and training to the BECs and that lack of guidance may result in inconsistent treatment of vendors. Guidance and training should include policies/procedures, use of statewide averages, periodic meetings, location review process, review of MORs, enforcement of regulations, etc.

If BEP staff do not have a good understanding of their essential duties and the amount of time that should be spent on specific functions, they will be unable to adequately perform their essential duties. As a result, the BEP cannot ensure the BEP facilities are operated at an optimum level, and the vendors get appropriate consulting and recommendations for changes to improve the profitability of the operation, which can directly impact the set-aside fees to the program.

- ***Duty Statements Are Not Reflective of Actual Duties Performed***

The time that BECs reported they spend on each function are not consistent with the duty statement. The following is a summary of BEP staff responses to the amount of time spent on primary duties:

BEC Duty Statement	Survey of BEC Duties Performed
30% Consultation Services	Varies from 15% to 50% Monthly
20% Location Reviews	Varies from 2% - 35% Monthly
20% Procurement Needs	Varies from 5% - 55% Monthly
10% Review MORs	Varies from 1%-20% Monthly

BEP staff stated that although BEP Administration and SBECs discuss the essential duties of the BEC, they do not formally discuss the percentage of time a BEC shall spend on each job function. BEP staff stated that job functions and percentage of time varies day by day based on the particular needs of vendors and the locations. BECs explained that they are getting the job done and that neither BEP Administration nor the SBECs have communicated otherwise, or that they need to spend more time reviewing MORs.

- ***Intent of the MOR Review Is Not Fully Understood***

Based on our review of BEC and SBEC staff responses regarding MOR reviews, it does not appear that BEP staff have a thorough understanding of the intent of the MOR review and/or the review process required by the BEP Procedures Manual. Ten of 12 BEP staff were unable to adequately explain the purpose of the review and monitoring of the MORs. Eight of the 10 BECs were unable to adequately explain the MOR review process.

If the MOR does not accurately report operations, it affects the statewide averages, RSA reporting, data used in facility announcements, set-aside fee, etc.

In addition, the Northern Region SBEC stated that he goes through each MOR, checks the cost of goods and labor to determine whether they are in line with the statewide averages, verifies that sales are in line with previous MORs and then signs and returns to the OT for filing. However, we found that for the sample of 10 location files reviewed for the Northern Region office, we found that for 83 MORs for 2006, only one was signed by the SBEC. He could not explain why all MORs were not signed.

If BEP program staff do not have a good understanding of the intent of the MOR review and do not follow the MOR review procedures, BEP cannot assure that all MORs are being accurately and adequately reviewed. In addition, vendors may not get appropriate consulting and recommendations for improving the profitability of the operation which directly impacts the set-aside fee to the program.

- ***Lack of Familiarity and Guidance with Location Review Process***

BECs reported that they have not received adequate guidance from SBECs regarding the location review process.

Although BECs appear to have a clear understanding of the purpose of location reviews and that reviews are completed by the BEC on a quarterly basis, they are not clear on what to do after the location review is completed. We found many BECs acknowledged the need to document the vending facility deficiencies when conducting a review; however, only one BEC stated that the deficiencies must be discussed with the vendor upon completion of the location review. Further, none of the BECs reported that a corrective action plan shall be discussed with the vendors.

Only two of the ten BECs recognized the location review tracking spreadsheet. In addition, both SBECs stated that they have not been monitoring the location review tracking spreadsheet for their assigned BEP Regional Office. According to the Assistant Program Manager, the tracking spreadsheet was designed for SBECs to monitor the location reviews performed by each BEC for their assigned locations.

It is important to note that the BEP Strategic Plan, Revised January 2007, has as an objective to clarify, strengthen, and support the role of the BEC. Key strategies include review/update the duties and responsibilities of BECs;

train BECs in these duties/responsibilities; and provide continuing education to BEP staff.

Criteria:

BEP is responsible for ensuring the proper administration of the program. As such, BEP must ensure that staff are adequately trained in the performance of their duties; and that regulations, requirements, and procedures are enforced and consistently applied to maintain the integrity of the program.

RECOMMENDATION:

BEP consider conducting a time study for BECs and SBECs to determine the actual time spent in specified performance areas. Once completed, compare the time study to the current duty statement to identify whether changes are needed, taking into consideration the deficiencies identified in this report and BEP priorities. Update the duty statements and discuss the changes with BEP staff.

BEP provide training to staff in the areas of MOR review, location reviews, vendor appraisals, and other areas necessary for the staff to perform their duties. BEP should consider using the BEP Trainer and the Department's Staff Development Section to assist in this area.

**FINDING 7 NOTIFICATION PROCESS FOR DELINQUENT FEES
AND MISSING MOR'S SHOULD BE REVIEWED**

Condition:

Although procedures are in place to notify BEP staff of delinquent fees and missing MORs, BEP staff reported that the current process should be reviewed to determine whether information could be available for review by BEP sooner in order for BECs to address issues in a more timely and effective manner.

Presently, MORs are to be postmarked by the 25th of the month following the report month as specified in regulation. As such, MORs may not actually be received until the end of the month. Before the Accounting Section enters the MOR information into the Business Enterprise Financial (BEF) system, a copy of the MOR is forwarded to the BEC which is usually around the 5th of the month. The Accounting Section then proceeds to enter the MOR information into the BEF system. If there are a lot of adjustments due to calculation errors, insurance rates, etc, the adjustment sheets and invoices may not be issued out to the BEC and vendor until the end of the following

month. Once the month is closed, Accounting notifies BEP that the information is available in the BEF system.

It is important to note that the BEP Strategic Plan, Revised January 2007, includes a strategy to automate the MOR process. However, since this action will not occur for several years, BEP should consult with the Accounting Section as to whether the current process can be improved given the fact that the MOR is not due to Accounting for almost a month after the report month.

RECOMMENDATION:

BEP, in consultation with the Accounting Section, determine whether this process can be altered given the current regulatory timeframe established for submission of the MORs. BEP may want to consider revising regulations to require the MOR be submitted sooner than the 25th of the following month. This would reduce the delay in receiving the MOR and evaluating the operations.

Based on the current regulatory timeframes and Department processes, there will most likely be some delay in receipt and posting of MORs. However, regardless of the timing of the notification, BEP staff must take timely and effective action, upon notice, when a vendor is delinquent on fees or has not submitted an MOR.

**FINDING 8 LACK OF APPROPRIATE AND TIMELY ACTION BY
BEP WHEN VENDORS FAIL TO SUBMIT MORs**

Condition:

BEP has not taken appropriate and timely action, as provided by regulations, when vendors fail to submit MORs. When vendors fail to submit MORs, BEP cannot assess the vendor operations and income, and set-aside fees due will not be paid. In addition, when a significant number of MORs are not submitted, the report to RSA will not accurately reflect the activities of the BEP.

For the period of July 2001 to March 2007, there were a total of 249 missing MORs by 44 vendors, which include 191 by 30 active vendors and 58 by 14 inactive vendors. Further, there were an additional 31 MORs missing by four inactive vendors from September 1995 thru June 2001. For the 30 active vendors that have outstanding MORs, 6 vendors have ten or more missing MORs and two vendors have 32 or more missing MORs from July 2001 through March 2007. These eight vendors account for 162 of the 249

missing MORs for the active vendors. Furthermore, a majority of the delinquent MORs are from the BEP's Northern Region Office, as many as 106 (90%).

The Bureau of State Audits (BSA) in its September 2002 report (#2002-031) identified lack of follow up by BEP regarding missing MORs. Specifically, BSA reported that BEP had not sent notices to vendors estimating the fees and penalties owed in a timely manner.

Based on the current MOR listing from September 1995 to March 2007, the trust fund may be due a minimum of \$102,068 in fees. The minimum amount was calculated based on a six month average of fees submitted for the location and/or the estimated fees for the location when the location was announced. In addition, since current procedures do not assess the late payment penalty until the MOR is received, late fees of approximately \$7,000 will be due.

In regards to the missing MORs, BECs stated that in some cases action is not taken due to the lack of enforcement of requirements by BEP management. Further, some BECs thought they had followed up with the vendor, some reported it was just an oversight, and some reported they have not had chance to get to it yet. In addition, the BECs stated that they have other priority work which has delayed the process. The Program Manager reported that he was not aware of this issue and did not know of any follow up.

Based on the sample period of January 2006 through March 2007, we identified a total of 118 missing MORs by 20 active vendors. For those 20 vendors, the number of delinquent MORs ranges from one to as many as 29 because some of the vendors have multiple locations. We found that either the procedures are not being followed or not appropriately followed by BEP as follows:

- For 39 (33%) of 118 missing MORs, we found no evidence that BEP sent any notices to the vendor regarding his/her missing MORs nor any documentation confirming any telephone conversation with the vendor regarding his/her missing MORs. Some BECs indicated they may have discussed the issue with the vendors verbally.
- Although BEP had sent First Notices in regards to 64 of 118 missing MORs, only 15 of the notices were sent timely (when 30 days delinquent). The remaining 49 notices were not sent timely in accordance with procedures. For example, for one vendor BEP only sent one notice out to the vendor on 6/22/2007 which included all 15 months of missing MORs, including the oldest which was due 18

months prior. Further, 11 of the First Notices contained more than one missing MOR in the notice which is evidence that the notices were not sent timely.

A total of 7 second notices were sent; however, only three had met the criteria which requires that after thirty days following the first notice, if the vendor has not submitted his or her missing MORs, the BEC shall contact the vendor by telephone and a second notice shall be sent. The other four notices were sent 70 days after the first notices were issued.

There were only two Third/Final Notices sent to vendors for the sample months reviewed. Both of the letters were done by the same BEC. However, it did not include the estimate of the charges for the missing MORs based on the BEP Announcement Report in the BEFS system to estimate the amounts owed for Liability Insurance, Workers Compensation Insurance and Fees owed to the Vending Facility Trust Fund; and that a twelve-month average shall be used as the basis for these calculations.

- The remaining 15 of the missing MORs belong to one vendor. Our review of the Vendor Financial System found that the vendor's MORs have been missing since 1/5/2004. The only delinquent letter sent, a First Notice dated December 29, 2005, to the vendor by his BEC was for the months April 2004 through October 2005 and we were unable to locate any follow up to this letter. Further, based on our interviews with staff and review of location file, it appears the vendor had in fact submitted all of the MORs for the operation of the BEP location; however, the Department's Accounting section was unable to accept the MORs due to concerns with the information reported on the MORs.

The Program Manager indicated he was unaware of this issue and did not know of any follow up to the December 2005 delinquent notice sent. However, based on our review of the vendor file and discussion with Accounting, we found many exchanges of communications on the missing MORs issue between the Accounting Section, BEP Program Manager, BEP Assistant Program Manager, the BEC, and the vendor. Furthermore, over three years later BEP has still not resolved this issue satisfactorily and the BEF system is still unable to accept the information submitted on the MORs.

It is important to note that BEP sent a letter to vendors in November 2006 regarding consequences for non-payment of set-aside fees and failure to submit monthly operating reports and accompanying payments. Further, in

December 2006, BEP sent a memorandum to all BEP staff regarding missing MORs and past due financial obligations outlining objectives and procedures to be followed by staff in these areas.

Further, as of October 2007 BEP, in conjunction with the Department's Legal Affairs Office, has served four actions (Notice of Intent to Terminate License and Operating Agreement) seeking to terminate the licenses and operating agreements of four vendors for failure to file MORs and pay financial obligations owed to BEP. The actions also demand payment of financial obligations owed to BEP, which total approximately \$109,310.

Criteria:

BEP is responsible for ensuring the proper administration of the program. As such, BEP must ensure that regulations, requirements, and procedures are enforced and consistently applied to maintain the integrity of the program.

RECOMMENDATION:

BEP must ensure that regulations, requirements, and procedures are enforced and consistently applied to maintain the integrity of the program. As such, BEP must take appropriate and timely action when vendors fail to submit MORs.

BEP verbally contact the vendor and follow up in writing about the missing MOR and that it must be submitted immediately and if not received by a specified due date, action will be taken. BEP shall then monitor, follow up, and document to ensure vendor compliance. For non-compliance, action must be taken in accordance with regulations. In addition, since vendors in the program are aware of the MOR submission and fee requirements, only one notice should be provided. BEP should not provide 2nd and 3rd notices as this is not an effective way to ensure compliance and enforce regulations.

**FINDING 9 LACK OF APPROPRIATE AND TIMELY ACTION BY
BEP WHEN VENDORS FAIL TO SUBMIT SET-ASIDE
AND OTHER MONIES OWED**

Condition:

BEP has not required staff to follow up or take appropriate and timely action when vendors fail to submit set-aside fees and other fees owed which directly impacts the trust fund balances and jeopardizes the integrity of the program. Further, by not actively pursuing set-aside fees and other fees owed, those monies will likely become uncollectible.

BEP staff reported that historically they have only been required to contact the vendor to remind him/her of owed fees when BEP receives the notice from the Accounting Section. However, the BECs neither document the discussion/conversation of the delinquency with the vendor, nor conduct any follow up. BECs stated that they do not send any additional notification letters to the vendors. The BECs that we spoke with during our review were unaware of any existing procedures for BECs to follow up on vendor delinquent fees.

BEC staff stated that they have made attempts to inquire about the delinquencies of vendors; however, they have been frustrated with BEP management's lack of consistency and enforcement of the rules and regulations. The Program Manager stated that BEP does not have adequate staff nor an adequate monitoring system in place to ensure the fees owed by vendors are followed up on. Further, the Program Manager stated that even after staff notify the vendor of delinquencies or that their license will be terminated, the process takes a long time so the fees owed by the individual vendor will keep on accumulating.

Currently, BEP is working with Legal Affairs to take action to terminate or set up payment plans for the vendors who owe significant monies to BEP. As of October 2007 BEP, in conjunction with the Department's Legal Affairs Office, has served four actions (Notice of Intent to Terminate License and Operating Agreement) seeking to terminate the licenses and operating agreements of four vendors for failure to file MORs and pay financial obligations owed to BEP. The actions also demand payment of financial obligations owed to BEP, which total approximately \$109,310. BEP is hopeful that in the near future, all of the delinquent fee issues will be addressed.

BEP management explained that one of the main reasons why the BEP started setting up payment plans for those vendors who had owed a large amount of money, is that the BEP wanted to recover the money, rather than terminate the vendor's license and likely be unable to recover any of the monies owed.

We obtained the most recent BEP Accounts Receivable listing from the Accounting Section. The list contained updated data as of 3/31/2007. The report includes 80 vendors (60 active and 20 inactive). The total amount of delinquent fees is \$384,155 of which \$239,678 is due from active vendors and \$144,477 is due from inactive vendors. Of the \$384,155 in delinquent fees, \$206,651 is for delinquent liability and workers' compensation insurance and \$125,004 is for delinquent set-aside fees.

Inactive vendors:

- For the 20 inactive vendors, delinquencies ranged from \$69 to \$35,096.

Amount Delinquent	# of Inactive Vendors
\$69 - \$1,000	6
\$1,001 - \$5,000	5
\$5,001 - \$10,000	5
\$10,001 and above	4

- It is probable that the delinquent fees owed from inactive vendors will become uncollectible. Two vendors have filed bankruptcy; and for 15 vendors, the Accounting Section has had to go to the Franchise Tax Board (FTB) to attempt collection through income tax refunds.
- One inactive vendor owed \$35,096 for 45 MORs for 2000 through 2004, which accounted for 24% of the total delinquencies for the inactive vendors. This vendor had a bankruptcy discharge approved in December 2004. The Accounting Section had sent out letters to the vendor regarding past due payments. The Department sought discharge from accountability in March 2006.

The vendor obtained his location in February 1999. We found evidence that BEP initiated some communications with the vendor in January and May 2000 regarding his failure to file MORs. However, after that time period we found no documentation to support any actions by BEP until October 2003, over three years later, when two letters were sent to the vendor by BEP. We found evidence that the Accounting Section was sending notices to the vendor of delinquencies on a regular basis.

The October 2003 letter written by the BEP Assistant Program Manager notified the vendor that due to the repeated and extensive delinquencies BEP had to forward the issues to the Department's legal division for review and consideration of license termination. On December 11, 2003, the BEP Program Manager issued and signed the Notice of License and Operating Agreement Termination of the vendor's operation of the BEP facility. The effective date and time of termination was 12/31/03 close of business.

On January 27, 2004, the vendor requested "a full evidentiary hearing." The hearing was scheduled on March 19, 2004. The Administrative Law Judge upheld the Department's decision to terminate the vendor's license in an order dated March 25, 2004.

The BEP Program Administrator stated at times the legal process takes too long and that was why some amounts had grown so large. For instance, this vendor would not leave the location so the Department had to take him to court, and it wasn't until early 2004 that the court ruled against him. Although we acknowledge that the legal process can take time, BEP did not take action to terminate the vendor in a timely manner. The vendor had been in violation of regulations almost since the time he obtained his location in 1999, but BEP did not act to terminate his license until December 2003.

Active vendors:

- For the 60 active vendors, delinquencies ranged from \$2 to \$64,094.

Amount Delinquent	# of Active Vendors
\$2 - \$1,000	38
\$1,001 - \$5,000	12
\$5,001 - \$10,000	4
\$10,001 and above	6

- For one vendor that has a delinquency of \$64,094, BEP staff reported that the vendor was allowed to compete for a new location by paying some monies and entering into a payment plan; and that after the new location was obtained, he defaulted on the payment plan. Further, since that time the vendor has filed for bankruptcy according to the Program Administrator. As such, the \$64,094 owed may become uncollectible. However, BEP continues to allow this vendor to operate a BEP facility. In fact, this vendor's current facility is a military operation in which he is reporting Income from Services on his MORs in the amount of \$15,000 a month as of November 2006.
- Another vendor has delinquencies totaling \$37,804 for the period of January 1994 through December 2006 relating to over 89 MORs. He filed bankruptcy in February 2003 and was allowed an initial and then a revised payment plan in 2004. His last delinquency was for December 2006; however, BEP continues to allow this vendor to operate a BEP facility.

Our survey of other states found the following in regards to late penalties:

- Maryland – For each offense: 1-5 calendar days late, penalty assessed of \$50; 6 or more days late, additional penalty of \$10 for each additional day beyond day 5.

- Michigan – If a set-aside fee payment is delinquent, a penalty of 50% of the monthly set-aside fee owed shall be assessed and paid with the next monthly report. Failure to submit 2 or more reports or payments during a 12-month period shall result in commencement of license revocation proceedings.
- Texas – To encourage operators to promptly file their monthly reports and pay their monthly set-aside fee, operators shall have their set-aside fee increased by 5% if either the report or fee is not received timely.
- Colorado – Operators shall be assessed \$100 late charge the first time either the set-aside payment or operating report is not received timely; \$200 the second time; \$300 the third and subsequent times. If late a total of five times, license terminated or suspended.

Criteria:

BEP is responsible for ensuring the proper administration of the program. As such, BEP must take appropriate and timely actions when vendors fail to submit set-aside and other monies owed; and ensure that regulations, requirements, and procedures are enforced and consistently applied to maintain the integrity of the program.

Title 9, CCR, §7221, requires each BEP vendor to submit a MOR by the 25th day of the following month for each BEP facility he/she operates. The MOR include a summary of the facility's operations that the Department uses as the basis for calculating certain fees owed to the program by the vendor, including Set-Aside Fees, workers' compensation insurance for vendor's employees, and liability insurance for the facility. Vendors are required to remit the fees to the program each month with their monthly operating report. A penalty not to exceed either 10% of the late set-aside fee or \$25, whichever is greater, shall be assessed against a vendor for late submittal of set-aside payments and financial statements (MORs).

Title 9, CCR, §7213.2 states that failure to pay set-aside charges, scheduled loan repayments or penalty charges on delinquent set-aside charges and/or scheduled loan repayments for more than 90 days; and failure to provide records or financial reports are ground for termination or suspension of a vendor's license.

BEP Procedures Manual, Section 11, Follow-up on Delinquency Notices or Accounts Receivable Invoices: The Accounting Office- Sends original to the vendor and a copy of the notice of delinquency or accounts receivable invoice to the FO. FO Clerical: Date stamps a copy of the invoice of

delinquency letters and forwards to BEC for review and follow-up. BEC: Reviews notice and contacts vendor. Obtains a commitment from the vendor to immediately correct the problem. If the vendor is unable to make the full payment requested, a payment plan is to be established. Submits the payment plan to the SBEC for review and approval. BEC: Monitor payments to ensure that vendor has met all deadlines. If the vendor fails to make timely payments, the BEC shall notify the vendor in writing that failure to meet program financial obligations may result in license suspension or removal from a location. Notify the SBEC of the problem.

SBEC: Monitors compliance with the payment schedule. Moves to suspend the license of any vendor that fails to comply with the terms of the payment plan.

RECOMMENDATION:

BEP must ensure that regulations, requirements, and procedures are enforced and consistently applied to maintain the integrity of the program. As such, BEP must take appropriate and timely action when vendors fail to submit set-aside fees and other monies owed as required. BEP should re-evaluate the current BEP procedures for delinquent set-aside fees and other fees owed to ensure timely action is taken and enforced against vendors who do not comply with regulations. BEP consider increasing the penalty assessed when vendors do not submit MORs and set-aside monies as required.

BEP verbally contact the vendor and follow up in writing about the delinquent fees and that the monies owed must be submitted immediately and if not received by a specified due date, action will be taken. BEP shall then monitor, follow up, and document to ensure vendor compliance. For non-compliance, action must be taken in accordance with regulations.

FINDING 10 INADEQUATE CONTROLS OVER THE USE OF PAYMENT PLANS FOR VENDORS WITH DELINQUENT SET-ASIDE OR OTHER MONIES OWED

Condition:

BEP allows vendors to enter into payment plans to repay delinquent set-aside or other monies owed; however the following deficiencies exist:

- There are no provisions for payment plans in BEP regulations. In addition, although procedures exist in the BEP Procedures Manual, BEP Administration stated that those procedures have not been followed for years due to the manual being outdated.

- Lack of Payment Plan Criteria. Procedures do not exist which identify the criteria and specific circumstances under which a payment plan would be considered and approved.
- Payment plan agreements are inconsistent, agreement language is not standardized, and the agreements are not reviewed by appropriate DOR staff to ensure appropriate language is included and to verify whether or not the vendor has existing funds to pay the delinquency. Payment plans do not include the consequences or actions that will be taken if the vendor fails to make payment in accordance with the payment plan or stay current on future MORs, fees, and insurance payments. The agreements are only reviewed by the Program Manager.
- BEP does not always notify the Accounting Section that a payment plan has been established. Accounting Section staff reported that they have to request information from BEP when they receive a payment and do not know where to apply the payment.
- BEP does not monitor the payment plans as required by the BEP Procedures Manual. In fact, the Program Manager stated that BEP does not maintain a list of the vendors who are currently on a payment plan; nor has BEP been tracking and monitoring the progress of payments by vendors.

Based on the information obtained from the Accounting Section, we identified BEP currently has six payment plans with six different vendors. According to the Program Manager, in order for BEP to recover delinquent fees, the program began allowing vendors to submit a portion of the monies owed on monthly basis:

- Usually, the amount and duration of payments is on case-by-case basis, and in most cases is based at the individual vendor's discretion.
- The payment plan is voluntary and is typically used for vendors who are planning to apply for another BEP facility; and/or who may have been contacted by the BEC regarding payment of delinquencies.
- Vendors who want to pay but are unable to pay the full amount would contact the Program Manager to propose a payment plan.
- Typically, the vendor will submit a plan stating how much they currently owe and how much they will pay on a monthly basis and it is approved by the Program Manager.

Our review found that most of the vendors did not follow through with their payment plan agreements. BEP has not enforced these agreements nor taken appropriate action against these vendors. Lack of payment of fees by

vendors directly impacts the funds available for administration of the program.

The Program Manager stated that BEP only relies on the Accounting Section's schedule of delinquent fees for the delinquent set-aside funds/other fees owed to the program by the vendors. The Accounting Sections' schedule only tracks monies owed and received.

Criteria:

The BEP Procedures Manual, Section 11.IV, states that the BEC reviews delinquency notice; contacts the vendor; and obtains a commitment from the vendor to immediately correct the problem. If the vendor is unable to make the full payment requested, a payment plan is to be established. The BEC is to submit the payment plan to the SBEC for review and approval. Once approved, the BEC prepares and sends written notification of the payment plan to the Accounting Office. The notification is to include a copy of the payment agreement. Copies of these documents are to be sent to the SBEC, BEP Administrator, and copies are to be filed appropriately.

The procedures manual further states that the BEC shall monitor payments to ensure that vendor has met all deadlines. If the vendor fails to make timely payments, the BEC shall notify the vendor in writing that failure to meet program financial obligations may result in license suspension or removal from a location. Notify the SBEC of the problem. The SBEC is to monitor compliance with the payment schedule and move to suspend the license of any vendor that fails to comply with the terms of the payment plan.

A memorandum, entitled Consequences for Non-Payment of Set-Aside Fees and failure to Submit Monthly Operating Report (MOR) and Accompanying Payment, was sent to all vendors on November 1, 2006.

A memorandum, entitled Missing Monthly Operating Reports and Past Due Financial Obligations, was sent to all BEP staff on December 8, 2006.

RECOMMENDATION:

BEP must ensure that regulations, requirements, and procedures are enforced and consistently applied to properly administer and maintain the integrity of the program. As such, BEP ensure timely action is taken against vendors who fail to submit MORs, set-aside fees, and insurance payments to avoid such an accumulation of delinquent fees, which should eliminate the need for payment plans.

If BEP decides to establish a policy to allow payment plans under unusual and exceptional circumstances, BEP must consult with Legal Affairs to determine whether this authority is required in regulations. In addition, procedures must be developed which identify the criteria and specific circumstances under which a payment plan would be considered and approved; and the process for monitoring compliance by vendors. Payment plans must not be entered into unless the vendor can provide financial data which demonstrates the vendor's inability to pay the Department the outstanding monies owed. Payment plan agreements must be standardized and reviewed by appropriate DOR staff, such as Legal Affairs and Contracts, to ensure required language is included.

BEP ensure the Accounting Section is notified timely, and provided a copy of the approved payment plan agreement, in order to carry out the collection function.

FINDING 11 LACK OF ADMINISTRATION AND OVERSIGHT OF PARTNERING AGREEMENTS AND OTHER SUBCONTRACTING ARRANGEMENTS

Condition:

The California State Auditor, Bureau of State Audits (BSA) in its September 12, 2002 audit report entitled, Department of Rehabilitation: Its Delay in Correcting Known Weaknesses Has Limited the Success of the Business Enterprise Program for the Blind (Report #2002-031), reported deficiencies in the Department's administration of partnering agreements and recommended the Department:

- Establish and follow guidelines for partnerships, ensuring that they are in agreement with federal and state law, regulations, and guidance.
- Require program staff to further study the cost and benefit of each partnership to ensure that future agreements do not inequitably drain program resources.
- Establish a review process for proposed private partnerships that will allow the department to adequately protect the interests of the State and program participants.
- Monitor partnerships to enable the department to compare the costs and benefits of partnerships and determine if they achieve program objectives.
- Ensure that program staff are able to monitor the success of all locations, including private partnerships.

A partnering agreement is a partnership between a BEP licensed vendor and a private food-service company to operate a BEP facility, typically a larger operation such as a military cafeteria, under the Randolph-Sheppard Act. BEP management explained that BEP started contracting with the Department of Defense (DOD) for their food service operations around the year 2000. However, since BEP vendors did not have expertise in running large food service operations, the Department allowed the vendor to apply for the facility and obtain a teaming partner (food service consultant), who would provide expertise and hands-on training to the vendor with the intent that the vendor would eventually assume the full responsibility of the operation over time. In return, the private food service company typically agrees to pay the vendor a guaranteed amount with or without a percentage of profits; or in one instance the vendor receives the profits remaining after certain specified costs are paid.

At the time of our review, the Department had 4 partnering agreements with the Department of Defense: Presidio of Monterey, Camp Parks Army Facility, Fort Irwin, and the Coast Guard. The food-service contracts ranged from \$400,000 to \$3.4 million per contract year. The Department also had 5 other non-military subcontracting arrangements; although BEP administration indicated it may not be aware of all such arrangements.

Our review found that although 5 years has passed since the BSA reported its findings and recommendations, deficiencies still remain uncorrected as follows:

Lack of Establishment of Formal Guidance, Rules, and Regulations

Even though BEP has allowed the use of partnering agreements for over 6 years, it has yet to establish any formal guidance, rules, regulations or procedures for such partnering agreements or other subcontracting arrangements to ensure the vendor and the Department are protected and that these agreements comply with the spirit and intent of the Randolph-Sheppard Act.

The BEP Strategic Plan, Revised January 2007, includes as a key strategy to revise BEP regulations to include authorization for using teaming partners in DOD contracts. Although the BEP is currently in the process of developing rules and regulations for administration and oversight of partnering agreements, this process has yet to be completed. Without established guidelines, the BEP may expose itself to noncompliance with regulations, unknown liability, unforeseen complaints, as well as vendor's grievances.

**Partnering Agreements May Not Contain Essential Contract Elements
And Are Not Reviewed by Appropriate Department Staff**

The contract language in the agreements is not consistent nor standardized and may not be adequate to protect the Department, vendor, and program. Without consistent contract agreement criteria, it may result in significant variations in how partners' assist and benefit the vendors in gaining business experience in operating food service facilities, how vendors are paid, and the impact on the set-aside fee.

- In reviewing the Vendor Support Agreements (agreement between the vendor and the partner) for the military operations, the role of the vendor is to operate and manage the food service contract. However, that role is not clearly defined. Regulations state that the vendor is responsible for managing and operating the vending facility along with liability insurance. Regulations further state that the vendor shall be personally accountable for the following: the level of goods and services; customer and agency relations; and health and safety standards.
- Lack of established training requirements, objectives, goals and timeframes in which the vendor will take over the operation and independently manage the food service facilities. Although the contracts stated that the role of the partner was to assist the vendor in moving towards independent capability, to obtain financing, and the ability to operate full food service contracts such as the one being performed, the contracts lacked specific details on how that would be accomplished and under what timeframes.

The Program Manager stated that currently it is the responsibility of the vendor to make the determination as to when the goal is accomplished and when he/she is able to independently manage the food service facility without the teaming partner.

- The agreement language is not consistent in who is responsible for the liability and worker's compensation insurance. One agreement states the vendor will obtain the insurance; one states the partner will obtain the insurance; and for the remaining two agreements, although the agreements state that the insurance will be obtained through an independent broker, they do not state who is responsible, the vendor or the partner. Only one agreement requires that the Department be provided with certificates of insurance or a copy of the annual renewal.

In discussions with the Department's Accounting Section, they were told by BEP that the partner's were covering the insurance. Further, without a reporting of sales the liability insurance cannot be calculated; and without a reporting of wages, the worker's compensation cannot be calculated for these partnering arrangements.

As such, the Department may not be in compliance with regulations which state that the vending facility shall not be operated without the BEP required liability insurance purchased by the vendor for the operation of the vending facility; and that the vendor shall provide BEP a certified copy of the insurance policy or a certificate issued by the insurance carrier, certifying the type and amount of coverage; and that the insurance shall cover the State of California.

- The recordkeeping requirements are not consistent in regards to who shall be responsible, the vendor or the partner. One of four agreements states that the vendor will keep and maintain the records. Three of four agreements state that the partner will keep and maintain the records. Additionally, none of the agreements identify what specific records are to be maintained.

Although all four agreements allow access to records by the Department, none of the agreements include record retention requirements. Regulations require that the vendor maintain required records on the operation of the facility for the current year plus three preceding years.

- Two of the four agreements included provisions for a letter of credit from the partner in order to secure the performance of the partner's obligations under the agreement and naming the Department as the beneficiary; and that the original letter of credit would be delivered to the Department. We were unable to secure a copy of the letters from the location files or BEP. It is unclear as to whether the agreements should contain letters of credit and how the Department would go about acting on this letter of credit should the need arise.
- Formal procedures are not in place for Departmental review of the partnering or other subcontracting agreements. The agreements do not involve the Department's Contracts & Procurement Section and/or Legal Section; but rather have mainly been reviewed and approved only by the BEP Program Manager. It is questionable whether the Program Administrator and/or Deputy Director have the authority or contract knowledge to sign the food-service contracts on behalf of the Department. In addition, BEP staff responsible for providing consulting

services and reviewing the operations stated that they are often not included in the partnering or subcontracting agreement process. Without adequate review guidelines and procedures, the Department could be potentially at risk for legal issues.

The BEP Program Manager indicated that he reviews the partnering agreements to ensure the vendor's role is spelled out, the method and amount of compensation is detailed, and the Department is protected. He thought that the Department's Legal Section had reviewed the agreements, and he acknowledged that the former Chief Legal Counsel opposed the DOD contracts. We only found evidence of Legal Section involvement in one of the partnering agreements. Further, he indicated the DOD contracts do not directly impact the set aside fund; and that all agreements are successful otherwise the Department would have heard from the military. No evidence to support these statements could be provided.

No Established Reporting for Partnering Operations

BEP does not have any established written procedures, policies, rules or regulations specific to the partnering agreements and subcontracts in regards to reporting of operations. None of the agreements included language on how the partnering operations would be reported to the Department. The current process of reporting utilizing the Monthly Operating Reports was not adequate to deal with often unique reporting of partnering agreements.

In three of the four agreements, the vendor is simply reporting the income (fee/commission) received from the partner. No reporting of sales/receipts or expenses/costs is reported.

For the other partnering agreement, expenses are being reported but sales are not. Further, as contract proceeds are paid by the military, the vendor is showing income from services on the MOR, but only when these payments are received which could be three months after the services were performed. As such, the income/receipts is not being matched with expenses for the same month which is what determines the set-aside fee. The vendor was actually showing a loss each month and rolling over the loss from month to month. Loss rollovers are not allowed based on the current MOR Instructions and regulations. Although, BEP has allowed these reportings to continue; and we found no evidence that BEP has worked with the vendor and Accounting to establish an appropriate reporting format and payment of set-aside fees.

Furthermore, prior to entering into these agreements dating back to 2000, BEP did not consult with Accounting, Legal, Contracts, or others to ensure everyone was on board with these agreements, that the process rolled out smoothly, and to ensure that the reporting of operations and set-aside, insurance, and any other issues were identified and resolved. As such, issues still remain.

Without a reporting of operations, BEP staff have not been able to appropriately monitor the partnering operations to ensure that the facilities are operated at an optimum level, what areas of improvement are needed, how to address deficiencies, and whether issues have been corrected. Additionally, BEP cannot ensure it is collecting an equitable share of fees from these arrangements which could impact the program.

Our review of the MORs for the 4 partnering agreements and 5 subcontracting agreements found the following:

- None of the MORs include gross receipts, opening/closing inventory and cost of goods sold, which is not in compliance with the current MOR and MOR Instructions. Furthermore, without a reporting of sales, liability insurance cannot be calculated.
- Eight of the nine vendors do not report the Payroll Expenses on the MORs, which are not in compliance with the MOR and MOR Instructions and could impact the calculation of workers' compensation.
- Five of the nine vendors do not report Operating Expenses on the MORs, which are not in compliance with the MOR and MOR Instructions.
- Four vendors include Operating Expenses on their MORs, however, not all of the itemized expenses reported on the MORs are allowable deductible expenses in accordance with the MOR and MOR Instructions such as DMV, Franchise Tax, and IRS; and one vendor reports Prior Period Loss Carry Over every month.
- Only three of the nine vendors reported and pay liability insurance on the MORs. The other six did not report any liability insurance on the MORs, which is not in compliance with the MOR and MOR Instructions and regulations.
- Eight of nine submitted their MORs based on proceeds that they received from the private companies rather than based on the operations of the facilities, which is not in compliance with the MOR and MOR Instructions. In addition, the Vending Machine Commission statements were not always included when reporting Vending Machine Income on the MORs.

Vending Facility Announcements Are Not Consistent And Do Not Agree with How the Fees are Actually Being Paid

Location	Set Aside Fee— Announcement
Presidio of Monterey	10% of net proceeds
Camp Parks/BT Collins	6% of net proceeds
Fort Irwin	6% of net proceeds to the vendor
US Coast Guard	10% of net proceeds

The partnering agreements do not specify what fee will be paid to the set-aside fund. In three of the four agreements, the vendor receives a commission/fee and sometimes also a % of profits. As such, a fee cannot be calculated from 'net proceeds' as required by regulations. For one partnering agreement, the vendor receives the proceeds remaining after certain payments are made from the monies received by the government. These are not typical operations or net proceeds as defined in regulations, so a proper fee cannot be calculated using the standard fee schedule.

Income to Vendors/Set-Aside Fees

The compensation to vendors identified in the agreements, subcontracts or proposals is inconsistent and unsupported. In most cases, there is no basis for how the compensation was determined. As such, the BEP cannot ensure vendors are receiving adequate compensation as a licensed program participant. In addition, without procedures and/or guidelines for establishing the compensation of vendors, it directly affects the set-aside fees to the program.

- Six of nine vendors pay 6% set-aside fees, however, the fee was based on the income (commission) received from the partners or subcontractors rather than based on the operations of the facility which is not in compliance with the regulations, MOR and MOR Instructions.
- Two vendors do not pay any fee, as their income received from the private partners or subcontractors is under \$1,508 (the minimum net proceed received by the vendor for operating a BEP facility, without paying any set-aside fees to the Trust Funds per Fee Schedule). However, the reporting is not in compliance with the regulations, MOR and MOR Instructions, because the set-aside fees shall be based on the net proceeds of the operation of the BEP facility, not the amount received from the private partners.

- For one vendor in a subcontracting arrangement, according to the BEC the vendor was paying an average of \$3,000 per month in set-aside fees. However, after making a subcontracting arrangement, the vendor is now only submitting \$420 per month in fees. In addition, this vendor did not obtain advance approval to enter into a subcontracting arrangement from BEP.
- One of four vendors in a partnering agreement does not pay set-aside fees based on income received. Although this vendor sent in his first MOR in January 2004, it wasn't until March 2006 that a letter was written by the vendor to the Program Manager indicating that he had not sent money to the Trust Fund, as he had not made any "net profit". However, the letter states the partnership loaned him money which "represents an estimate" of what he thinks the profits will be and sent in \$16,425 which was 6% of what he was loaned. In addition, he has paid \$675 monthly since that time (through 12/2006). None of this is reported on the MORs submitted as it is unclear to the vendor and BEP how to report on this operation. In fact, the Accounting Section has been unable to input the MOR data into the BEF system due to the unique reporting for this location and the large negative amounts reported. Further, questions regarding the reporting for this location go back to 2004 and still remain unresolved by BEP. We found the money sent in was reported in the uncleared collections for a total to-date of \$22,500.

The vendor has been at this location since January 2004. Our review of the MORs submitted by the vendor for 2004-2006 has shown losses since this agreement began. The MORs have yet to show a net profit. In fact, the vendor is carrying over losses from month to month, and year to year. Further, BEP has no idea what the vendor's net proceeds actually are or should be and how to determine the payment into set-aside. Even though partnering agreements do not require major funding at startup according to the BEP Program Manager, as BEP does not purchase the equipment, there are still program costs for these locations such as consulting and vendor benefits.

Although the MORs indicate this vendor has lost large amounts of money since he started at the location in January 2004 (from \$74,462 to \$1,019,832), it does not appear the Department is monitoring this situation. While we found many emails to the Program Manager from the BECs regarding this vendor's MORs, we were unable to find a response to the emails. Further, we found many emails from Accounting to the Program Manager regarding the MORs since January 2004, as they

have not been able to input these MORs into the BEF System due to the way the MOR is reported and therefore the MORs (at times late and no MOR for October 2004) have been considered missing in the system. The Program Manager has indicated in several emails that he will be meeting with the Bookkeeper to ensure the MORs are compliant with the Instructions. However, in our meeting with the Program Manager, he indicated he has never met with the bookkeeper.

Reporting of Partnering Arrangement on the RSA-15 Report

Without the required reporting elements of the MOR : Gross Receipts, Opening/Closing Inventory, Cost of Goods Sold, Operating Expenses, Operating Profit, Vending Machine and Other Income, Net Proceeds, and Set-Aside Fees, the Department may be reporting inaccurate information to the RSA on the RSA-15 Report of Vending Facility Program. Specifically, the report requires Gross Sales, Merchandise Purchases, Gross Profit, Other Operating Expenses, Operating Profit, Vending Machine and Other Income, Net Proceeds, and Funds Set Aside. Although BEP indicated that for the 2006 RSA-15 report they obtained information from the partners on the gross receipts and net income for use in reporting; however, it is still unclear on how the operations can be adequately reported if not all information is available.

Lack of Adequate Monitoring of Locations

- BEP staff indicated they had little or no knowledge or involvement in Partnering Agreements or subcontracting agreements, or what their involvement should be. Several felt they had no rights to interfere with the food service partner. However, some BEP staff did indicate they would like some instruction and guidance so they can appropriately monitor the facilities.
- BEP is not adequately monitoring the vendors training by the partner to ensure that the vendors are making progress towards the goal to eventually take over the facility. No specific timeframes for the training to be completed are documented in the agreement or in the BEP files. There is no progress report/evaluation conducted by BEP or the partner identifying where the vendor is in his training plan nor his progress. We found that three vendors have been on location in the military facility since 2004 and one since 2005. The BEP has not performed any evaluations nor has any knowledge as to how far the vendor has come to meeting the stated objectives and goals.
- For locations with a partnering agreement, we found that the locations have not been appropriately monitored in regards to operations; nor

have location or vendor appraisals been conducted. Without adequate monitoring the BEP is not able to ensure the vendors are benefiting from the teaming partners, whether the teaming contracts are providing the vendors a sufficient income, and ultimately whether the teaming partner contracts are worthwhile.

The BEP Program Manager stated he realizes that no staff is monitoring the partnering agreements, however, he stated that he/himself communicates with some of the vendors and knows that they are progressing, but there is no formal appraisal, evaluation or documentation to support his statements. Further, he reported that he believes two of the vendors operating military bases with a teaming partner are almost ready to be able to take over the facility on their own; however there is no support to substantiate these statements. In fact, according to the MORs submitted by one of those vendors, he has not gained any positive net proceeds yet even though he entered into this military base teaming partner contract in January 2004. As for the other vendor, he notified BEP that he has filed bankruptcy. The BEP Program Manager also indicated that he does know that DOD contracts offer the vendor the opportunity to sit on his/her hands and not get involved.

Inconsistencies in the Vendor Agreement and Between the Vendor Agreement and Subcontracting/Partnering Agreement Exist

Without consistent and clearly written requirements identified in the agreements, the basic terms of the program are not established. In addition, the BEP may be prone to unforeseen legal matters.

Location 3-1007 Camp Parks/BT Collins had the following inconsistencies:

- Vendor Agreement, Exhibit "B", states that the monthly income of the vendor shall be the net proceeds of the business of the Vending Facility less the fees paid to the Vending Facility Trust Fund. This is inconsistent with the statement in Vendor Agreement, Exhibit "C", which requires the vendor to submit an MOR and to pay a fee of 6% of the monies remitted to the vendor by BCI.
- Exhibit "B" states the business/premises of the vending facility shall be covered by public liability, and the cost of such insurance shall be borne by the vendor; however the Vendor Support Agreement states that the liability insurance is to be covered by the teaming partner.
- Vendor Agreement, Exhibit "B", states the vendor shall pay all debts arising from the operation of the vending facility. However, the Vendor

Support Agreement states the teaming partner assumes the financial and performance risk of the contract as part of its mentoring role.

Location 7-0784 (Calipatria/Centinel State Prisons) had the following inconsistencies:

- Vendor Agreement, Exhibit "B", states the business/premises of the vending facility shall be covered by public liability, and the cost of such insurance shall be borne by the Vendor....; and Exhibit "C" states indicates it will be the responsibility of the vendor to secure and place on file with BEP, current liability and worker's compensation insurance certificates with coverage as required by BEP and that in order to be covered under the BEP insurance policy, the Vendor will pay liability insurance to the Vending Facility Trust Fund an amount based on the gross income.

However, the subcontract indicates the subcontractor shall procure Worker's Compensation Coverage and Employer's liability insurance and shall name the vendor and BEP (State of California) as additional insured parties.

According to the Assistant Program Manager, BEP has new staff and there has been no training to assist them in this area.

Criteria:

Title 34 Code of Federal Regulations (CFR) §395.3 states that the state licensing agency will cooperate with the Secretary in applying the requirements of the Act in a uniform manner; take effective action, including the termination of licenses, to carry out full responsibility for the supervision and management of each vending facility in its program in accordance with its established rules and regulation, this part, and the terms and conditions...adopt accounting procedures and maintain financial records in a manner necessary to provide for each vending facility and for the State's vending facility program a classification of financial transactions in such detail as is sufficient to enable evaluation of performance.

Welfare & Institutions Code §19639 indicates the director shall adopt and promulgate necessary rules and regulations... The director shall review these regulations for possible revision at least every three years. These regulations shall include, but not be limited to: ...a fair minimum of return to vendors; standards for training, in-service training, and upward mobility; the policies and procedures used by the Department for collection and deposit or disbursement of all vending facility income, including, but not limited to,

the frequency, rules regarding, and method of collection of funds from facilities operated by licensed blind vendors...

Title 9, CCR §7217 states the vendor shall not purchase, lease, borrow or contract for equipment or services for the vending facility without the authorization of the BEP.

Title 9, CCR §7720 (g) states the vending facility shall not be operated without the BEP required liability insurance purchased by the vendor for the operation of the vending facility. The insurance shall also cover the State of California and, if necessary, the agency named in the permit as additional insured. The vendor shall provide BEP a certified copy of the insurance policy or a certificate issued by the insurance carrier, certifying the type and amount of coverage. The vendor shall, within 24 hours, report to BEP and the insurance carrier any liability claim or accident occurring at the vending facility.

Title 9, CCR §7720 states the vendor is responsible for managing and operating the vending facility; the vendor shall be personally accountable for all of the following: the level of goods and services; customer and agency relations; maintaining and operating the facility; the vendor shall maintain required records on the operation and such records shall include: Monthly Operating Reports; worksheets used to prepare monthly operating reports; sales register; daily cash report; cash register tapes; records on other operation receipts; the vendor shall take and report the physical inventory of the merchandise and supplies twice annually...

Title 9, CCR §7220 (j) states the vendor shall maintain required records on the operation... Upon written request, books of accurate account and records pertaining to a vending facility operation shall be made available for examination and audit by the Department...such records shall include Monthly Operating reports, work sheets used to prepare monthly operating reports, sales register, daily cash reports, cash register tapes, records on other operation receipts, Board of Equalization reports, bank deposit receipts, purchase register, invoices from purveyors, canceled checks, records on other operation purchases, physical inventory, etc.

Title 9, CCR §7221, Vending Facility Trust Fund and Set-Aside Charges, states that payment shall be based on the net proceeds of the vending facility for the preceding month, and shall not exceed six percent of the monthly gross sales. A vendor using BEP owned equipment or operating a vending facility on premises authorized by a permit shall pay a set aside charge...Payment shall be based on the net proceeds of the vending

facility for the preceding month...Net proceeds are determined by deducting allowable expenses excluding set-aside charges from the monthly gross income...to include subsidies, vending machine commissions...

Title 9, CCR §7211 states the Vendor Agreement is an agreement between a vendor and BEP establishing basic terms and conditions for operation of a vending facility.

Title 9, CCR §7220 (c) states that BEP shall furnish a copy of the vending facility permit and the vendor's operating agreement to each vendor. The permit shall be provided to the vendor prior to his/her execution of the operating agreement. BEP shall arrange for these documents to be read and explained to each vendor. The vendor shall sign a witnessed statement verifying that these documents have been read, explained, and the provisions understood. This statement shall be signed each time a vendor commences operation of a vending facility.

Title 34 CFR §395.9 states the state Licensing agency shall establish in writing the extent to which funds are to be set aside or caused to be set aside from the net proceeds of the operation.... funds may be set aside...for the purpose of...the establishment and maintenance of retirement or pension funds, health insurance contributions, and provision for... This section further states that the State-licensing agency shall establish in writing the extent to which funds are to be set aside or caused to be set aside from the net proceeds of the operation of the vending facilities and, to the extent applicable, from vending machine income...

Welfare and Institutions Code §19629 states the Department shall provide that, if any funds are set aside, or caused to be set aside, from the net proceeds of the operations of the vending facilities those funds shall be set aside, only to the extent necessary, but not to exceed the amount equal to 6% of gross sales, and may be used only for the following purposes: Maintenance & replacement of equipment; purchase of new equipment; construction of new vending facilities; funding the functions of the committee of blind vendors; retirement or pension funds, health insurance contributions or premiums, life insurance contributions or premiums to the extent approved by the federal RSA, and provisions of sick leave or vacation time or business related insurance...net proceeds shall be the sum of the amount remaining from the sale of articles or services and the amount of any vending machine or other income accruing to blind vendors after the cost of sale and other expenses.

Title 9, CCR §7211 states the Business Enterprise Consultant or BEC means the individual employed by the Department to provide technical assistance to vendors in the operation of vending facilities within an assigned geographic area. The BEP Procedures Manual also states to ensure the vendor's have copies of the rules and regulations, to inform vendor's of procedures to obtain benefits and insurances, and to monitor Monthly Operating Reports, complete Location Reviews and Vendor Appraisals to ensure the success of BEP locations.

Rehabilitation Administrative Manual (RAM) Chapter 7 states a contract is a binding financial agreement between the Department of Rehabilitation and a second party or person. It further indicates the Chief of the Budgets and Contracts section of the Department has the overall responsibility for the administration of the contracting process and the Contract Officer is the individual in the Budgets and Contracts Section responsible for the determination of contractual requirements...

34 CFR §395.1 (j) indicates management services means supervision, inspection, quality control, consultation, accounting, regulating, in-service training and other related services provided on a systematic basis to support and improve vending facilities operated by blind vendors.

BEP Procedures Manual Section 11.0, Monitoring Locations, indicates the BEP staff perform many evaluations to ensure the success of BEP locations. These evaluations assist in identifying areas which need specific attention, changes or improvement by both BEP and/or the vendor managing the facility. This section includes the MOR, the Vendor Appraisals; the Review of Location; Combining locations; Articles of Agreement; and preparing Vendor Agreements.

The Vendor's Monthly Operating Report Instructions indicate the Vendor's Monthly Operating Report is completed each month to report sales, expenses and profit. It is used to evaluate operations, develop required reports for federal and state governments, and establish set aside fee, and insurance payment amounts. The instructions indicate what to input on each line.

RECOMMENDATION:

BEP provide proper administration and oversight of partnering agreements and other subcontracting arrangements by taking the following actions:

- Establish formal guidance, rules, and regulations governing partnering and other subcontracting arrangements in consultation with RSA.
- Ensure agreements contain essential contract elements, roles, and responsibilities, and are reviewed by Legal Affairs, Contracts & Procurement, and other appropriate DOR staff. The agreements must specifically identify who will be responsible for liability and workers' compensation insurance, the vendor or the partner/subcontractor; and that the Department be provided with evidence of insurance.
- Develop a reporting mechanism, similar to the MOR and Instructions, specifically for partnering and subcontracting arrangements.
- Ensure partnering agreements include established training requirements, objectives, goals and timeframes in which the vendor will take over the operation and independently manage the food service operation. Further, monitor progress to ensure progress is being made and timelines are met.
- Ensure agreements have appropriate language regarding who is responsible for the records, the record retention requirements, and that records are subject to audit and review.
- Involve the BEC and SBEC in the process. Provide training and guidance in the performance of their consulting and monitoring of these operations.
- Establish, and include in the agreements, reporting requirements to ensure BEP receives data on the operations such as sales, expenses, cost of goods, etc in order to properly evaluate and monitor the locations success; identify where improvements can be made; ensure deficiencies are corrected; ensure an accurate and fair return to the vendor and the program; and to assist in completing the RSA-15 report.
- Ensure facility announcements are consistent and correctly report the operation and the fees to be paid.
- Take a more active role with the vendor in the determination and basis of the vendor's compensation. Consider making these arrangement's more consistent—commission based or based on net proceeds.
- Ensure the Vendor Agreement language is consistent; and is consistent with any subcontract/partnering agreement.
- Respond timely to vendor and BEP staff requesting assistance in reporting and monitoring of these facilities and operations.
- Consult with the CVPC in these efforts, where appropriate.

FINDING 12 BEP VENDOR AGREEMENTS ARE NOT ADEQUATE AND ARE NOT ALWAYS PROVIDED IN ACCORDANCE WITH REGULATIONS

Condition:

Based on our review of 15 BEP Vendor/Location files, we found that Vendor Agreements (DR 469) are not adequate, and were not established or not completed timely in compliance with regulations.

The Vendor Agreement is the agreement between the BEP and the vendor. Regulations state that BEP shall grant the right to operate a vending facility to a vendor through a written operating agreement. BEP shall furnish a copy of the vendor's operating agreement to each vendor and shall arrange for these documents to be read and explained to each vendor. The vendor shall sign a witnessed statement verifying that these documents have been read, explained, and the provisions understood. This statement shall be signed each time a vendor commences operation of a vending facility.

BEP Vendor Agreements Are Inadequate

- All 15 of the Vendor Agreements reviewed (which included Agreements commenced between 1993 and 2007) had referenced outdated regulations.

Specifically, Exhibit "B" Conditions of Vending Facility Agreement, I. General Conditions 7, indicated "The Vendor and State shall function within the Regulations of the State as stated in Title 22 of the California Administrative Code, Division 1.8, Chapter 1, Subchapter 5, Article 12 and abide by applicable federal, State or local laws and regulations". Title 22 is outdated and the current reference is Title 9, California Code of Regulations, Chapter 6, Business Enterprise Program for the Blind. The Assistant Program Manager indicated this was something that was overlooked and that this section of the Vendor Agreement would be updated.

Incorrect citations/references to regulations in the Vendor Agreement can hinder the participants understanding of the requirements and possibly the legal authority of the agreement.

- Agreements could be significantly improved by providing language such as the following:
 - ✓ Record retention requirements.
 - ✓ Financial reports and records are subject to audit.

- ✓ Vendor shall operate the facility in accordance with sound business practices and in accordance with applicable state and federal laws.
- ✓ Requirement to pay set-aside, liability insurance payments, and submit MORs; and consequences for non-compliance to include penalties, termination of license, etc.
- ✓ Vendor shall maintain adequate accounting records
- ✓ Vendor shall work cooperatively with BEP in the management and administration of the BEP including audits/reviews, location reviews, vendor appraisals, etc.
- ✓ Vendor shall submit to medical examination to determine whether vendor still meets eligibility requirements; reviewed annually.
- ✓ Vendor expected to meet a minimum annual net profit or net profit percentage and consequences for not meeting expectations.
- ✓ How vendor/location will be evaluated.
- ✓ Not enter into subcontracts without BEP approval. Subcontracts cannot reduce the set-aside fee to the program.
- ✓ Define what material breaches are and that these breaches will result in termination of the license and agreement.
- ✓ Vendor take appropriate actions to correct deficiencies noted in writing from BEP reviews, facility audits, and the like within 30 business days or agreement will be terminated.

The above listed is provided based on our review of the Department's Vendor Agreement and vendor agreements established by the following States: Maryland, Colorado, Florida, Alaska and Arizona.

Agreements Not Established or Not Completed Timely

We identified the following deficiencies during our review:

- Two of 15 locations reviewed had no Vendor Agreement on file and BEP staff were unable to provide evidence that a Vendor Agreement was established. The vendors have been operating their facilities since 2004.
- Eight of the 15 Vendor Agreements were not completed on a timely basis. We found some vendors had been operating the BEP facility without a signed Vendor Agreement and that it was three months to over 13 years before they were signed by all responsible parties.

The Assistant Program Manager indicated that this was due to a clerical staff shortage. In addition, he stated in some instances the vendors would not sign the Vendor Agreement, or in the case of one vendor there was no

permit for the location. The BEC worked with building management and a permit was finally signed and then the Vendor Agreement was completed.

Without a Vendor Agreement or without a signed witnessed statement verifying that these documents have been read, explained, and the provisions understood, prior to when a vendor commences operation of a BEP vending facility, BEP is in violation of regulations.

Criteria:

Title 9, CCR §7211 states the Operating (Vendor) Agreement is an agreement between a vendor and BEP establishing basic terms and conditions for operation of a vending facility.

Title 9, CCR §7312 (c) states that the BEP shall grant the right to operate a vending facility to a vendor through a written operating agreement. The basic terms and conditions shall be developed by BEP in consultation with the CVPC.

Title 9, CCR §7220 (c) states BEP shall furnish a copy of the vending facility permit and the vendor's operating agreement to each vendor. The permit shall be provided to the vendor prior to his/her execution of the operating agreement. BEP shall arrange for these documents to be read and explained to each vendor. The vendor shall sign a witnessed statement verifying that these documents have been read, explained, and the provisions understood. This statement shall be signed each time a vendor commences operation of a vending facility.

RECOMMENDATION:

BEP comply with regulations and ensure Vendor Agreements are established and signed by all parties in a timely manner.

BEP strengthen Vendor Agreements, in consultation with the Department's Contract & Procurement Section, by including correct citations to regulations and other language suggested in this report to ensure the vendors are aware of their responsibilities and the actions that will be taken for non-compliance.

FINDING 13

VENDING MACHINE CONTRACT LANGUAGE COULD BE IMPROVED TO PROVIDE BETTER ACCOUNTABILITY AND COMPLIANCE

Condition:

Vending Machine Contracts contained many of the essential contract elements; however, language could be improved to provide better accountability and compliance.

The Department contracts with the general public for operating a vending machine facility located within a federal or state building instead of operating those facilities by BEP licensed vendors, because the Department has determined that those facilities are not viable locations for a vendors to operate. In return, the vending machine contractors or private businesses must pay a percentage of the net sales or income (vending machine commission) to Department. The commission is used to fund the retirement plan for all BEP participants. The contractor submits a monthly or quarterly sales report to the Department along with a commission payment, which is based on the contractual commission rate stated in the contract.

The Department could strengthen the contracts by including language in the following areas:

- ✓ Penalties and actions to be taken for non-submission or late submission of commission payments and sales reports. For example:
 - Connecticut included this statement: Late commission payments are cause for terminating the contract, and are subject to a 20% penalty plus 1 ½ % interest per month.
 - Texas states that if the contractor does not follow the reporting instructions, Texas reserves the right to assess the following penalties: Failure to properly report any of the information will result in a penalty of \$190 per facility per machine. All penalties are due 10 days after notification by separate check. If penalties are not received within 10 days, an additional \$20 penalty will be assessed.

If sales and commission report is not submitted by the due date and/or the payment does not match the report, the contractor is subject to a late penalty of 3% of that month's gross sales. If the penalty payments are not receive by the end of the calendar month the report was due, an additional 3% of gross sales and an additional \$20 penalty will be assess. If these penalties are not paid by the end of the 2nd month, Texas may cancel the contract in its entirety and exercise the performance bond.

- ✓ The Department will seek collection of all outstanding monies owed.
- ✓ Subcontracting language could be improved to require Department approval of the subcontracting arrangement. For example, Montana uses the following language:

Restrictions on Assignment and Subcontracting: Contractor agrees to provide for the compliance of any subcontractors with applicable department, state, and federal requirements and assurances of this contract. All applicable contract provisions will be of the same force and effect on a subcontractor as on the Contractor. The Contractor agrees to insure that all applicable provisions of the final contract are included in any subcontracts entered into by the Contractor. The Contractor agrees not to enter into subcontracts for any of the services or work to be provided under this contract without prior written approval of Department. All subcontracts entered into by the Contractor must be in writing and contain all provisions as may be required by this contract. Approval of any subcontract does not make the Department a party to that subcontract nor create any right, claim, or interest by the subcontractor against the Department. The Contractor must give the department immediate notice of any litigation concerning a subcontract.

In addition, the Department has not formalized, in writing, procedures for Department staff to follow when vending machine contractors fail to submit commission payments and sales reports. Although written procedures do not exist, staff stated they follow up on delinquencies as follows:

- ✓ Send letters out to the contractors to advise them that of delinquent payments.
- ✓ Follow up with a telephone call to contractors instructing them to comply with the contract provision.
- ✓ Promptly document the response/explanation of the contractor, and/or the action and time frame verbally offered by the contractor to correct the violation.
- ✓ Immediately send a certified letter confirming and summarizing the context of the phone conversation and concluding with a reminder that a possible consequence of such non-compliance may be the termination of the contract.

Without appropriate contract language and a formalized process to take action against contractors who do not comply, the vending machine commission income may be lost. Also, if staff turnover occurs, new staff may not be aware of the collection procedures.

It is important to note that the Department's Contract & Procurement Section, in consultation with BEP, is changing the contract methodology to a 'flat-rate' commission versus a percentage of sales commission. In addition, changes are being made to the contract language which will address non-payment of revenues and terminating the contract.

Criteria:

Welfare & Institutions Code §19630 (c) states the director shall . . . be responsible for the collection of, and accounting for, vending machine income. Section (d) states that BEP shall contract or authorize a vendor to contract for services and commissions from vending machine entities . . .”

RECOMMENDATION:

The Department revise the Vending Machine Contract language to provide improved accountability and compliance by the contractors. In addition, the Department establish formal written procedures to be followed when contractors fail to submit commission payments and sales reports as required by the contract; and take appropriate action.

CHAPTER 2: LIMITED REVIEW OF 2005 INTERNAL CONTROL CORRECTIVE ACTIONS
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Audit Services conducted a limited review of the 2005 Internal Control Review deficiencies. The review was limited to verification of completed actions reported in the 1-year corrective plan submitted to Audit Services on January 22, 2007. Although a review was not conducted on pending action items, the Department should continue its efforts to complete pending actions in accordance with the reported timeframes.

**FINDING 1 THE TIMELINESS OF CONTRACT SUBMISSION AND
APPROVAL COULD BE IMPROVED**

Condition:

The 2005 Internal Control Report indicated that case service and cooperative program contracts are still not always approved prior to the commencement date of the contract. As a result, the Department identified corrective actions to be taken. We determined that the following corrective actions have been taken:

- A comprehensive contract renewal log is being maintained on the Department's shared drive.
- A memo was issued to Department Contract Administrators in February 2006 regarding timely submittal of contracts and third party agreements.
- A letter was developed in March 2006 and sent to contract partners to inform them of the requirements for timely submission of contracts to the Department and DGS.
- The importance of submitting accurate, complete, and timely contract packages was discussed with Department Rehabilitation Specialists/Contract Administrators at contract trainings conducted October 4-5, 2006.

We reviewed the contract renewal logs to determine whether the corrective actions implemented resulted in improvements to timely submission and approval of contracts. We observed that although the Department has reiterated the importance of submitting accurate, complete, and timely contract packages, there has not been significant improvement in the timeliness of contracts submitted in draft to the Department and in final for DGS approval.

Submission of 2006/2007 and 2007/2008 Draft Contracts to DOR

Our review of the Collaborative Services Section Contract Log for Fiscal Year 2006/2007 indicated that 53 of 203 (26%) draft contracts were not submitted to the Department by the established due dates. Specifically, 31 case service contracts/mental health cooperative contracts were not submitted by the January 31, 2006 due date and 22 education cooperative contracts were not submitted by the February 28, 2006 due date.

Our review of the Collaborative Services Section Contract Log for Fiscal Year 2007/2008 indicated that 91 of 198 (46%) case service contracts, mental health cooperative contracts, and education cooperative contracts were not submitted to the Department by the established due date of January 15, 2007.

Fiscal Year 2006/2007 and 2007/2008 Contracts Not Approved by DGS Prior to the Effective Date

We reviewed the Contract Section Contract Log for Fiscal Years 2006/2007 and 2007/2008 and found the following:

- Of 203 contracts for Fiscal Year 2006/2007, 55 (27%) contracts were not approved by DGS prior to the effective date of the contract.
- Of 198 contracts for Fiscal Year 2007/2008, 83 (42%) contracts were not approved by DGS prior to the effective date of the contract. In addition, as of November 2007 we observed that 10 of 198 contracts are still pending of which 4 were sent out for contractor signature and have not yet been returned.

Based on comments noted by Department staff on the contract renewal logs, some of the reasons the contract submission deadlines were not met included:

- Changes were needed to the contract budget.
- Contracts were misplaced by the Contractor.
- Contracts were held for 30-60-90 days by the Contractor before forwarding a signed copy to the Department.
- Contractor did not provide all parts of the contract to the Department.
- Contractor was delayed in obtaining a Board Member's signature.

If contracts are not submitted timely, the Department is at risk of contracts being returned unapproved by DGS or having the effective date of the contract be the date of DGS approval rather than the desired effective date.

Further, the Contractor is at risk of not receiving payment for services provided prior to the date the contract is approved by DGS.

Collaborative Services reported that prior to the 2007/08 Fiscal Year, the Department policy was to contract for up to three fiscal years, but only establish a budget for the first fiscal year. This policy necessitated an annual contract amendment to identify a new budget prior to the beginning of each new fiscal year. However, the Collaborative Services Section and the Contract Section instituted a new contract policy for Fiscal Year 2007/08 which permitted contract amendments to establish budgets for the duration of each three year contract. As such, Collaborative Services reported that 126 of 196 (64%) cooperative and corresponding case service contracts are fully executed for Fiscal Year 2008/09. Only 70 (36%) cooperative program contracts need to be renewed for Fiscal Year 2008/09.

Criteria:

The Department requires timely submission of draft contracts in order for the contracts to be processed and submitted timely to DGS for approval. Due dates for draft contract submission were established by the Department's Cooperative Services Section. The Rehabilitation Specialists/Contract Administrators were informed of the due dates at the annual contract trainings held on September 26-27, 2005 (for 06/07 contracts) and October 4-5, 2006 (for 07/08 contracts).

DGS requires timely submission of contracts in order for the contract to be approved by the effective date. The Department has established that contracts must be submitted to DGS at least 30 days prior to their effective date, otherwise they are in jeopardy of being unapproved or having the effective date changed.

State Contracting Manual (SCM) §4.09 A. states the basic state policy is that no contractor should start work until receiving a copy of the formally approved contract. The law provides that when DGS approval is required, contracts for services should not begin before receipt of approval; payment for services may not be made until the contract is approved by DGS.

RECOMMENDATION:

The Department continue its efforts to improve compliance with the contract submission requirements to ensure contract drafts are submitted to the Department by the established due date and to ensure timely DGS approval.

FINDING 2 THE BANK DRAFT MONTHLY SARS REPORT COULD BE IMPROVED FOR MORE EFFECTIVE MONITORING

Condition:

The 2005 Internal Control Report indicated that staff were not compliant in the areas of authorizing, issuing, and monitoring Bank Drafts issued to consumers. As a result, the Department identified corrective actions to be taken. We determined the following corrective actions were taken:

- An email announcement was sent to field staff on July 6, 2006 with bank draft related information including: allowable purchases service codes; vendor acceptance and handling of bank drafts; a reference guide; authorization flowchart; and procurement file documentation requirements.
- At the statewide OSS meeting on June 20-21, 2006, an ad hoc report showing all bank drafts created by District was shared with the OSSs. They were instructed to review the report with their respective District management teams. It was agreed that data on the report would be captured in a monthly SARS (Sysout Archival and Retrieval System) report for monthly monitoring of bank draft usage.
- Regional OSS meetings for both the Northern and Southern region were held on April 19, 2007 and April 24, 2007, respectively, to discuss bank draft resources.
- A DORALL was sent on March 22, 2007 to inform staff that RAM Chapter 16 had been revised. RAM Section 16185 includes instructions and processes for voiding, encumbering, and disencumbering bank drafts.

We performed a limited review to determine whether the corrective actions implemented resulted in improvements to monitoring of bank drafts.

The monthly SARS report was created to assist in the bank draft monitoring process. However, we observed that the monthly SARS report, first developed for the month of February 2007, may not be as effective as the quarterly ad hoc report that was previously utilized to monitor usage.

The ad hoc report provided information on a quarterly basis thus the status of a bank draft printed in previous months could still be identified on the ad hoc report. This is beneficial so additional staff time and resources would not be spent on researching if a bank draft was cashed. Also, the ad hoc allowed for better identification of potential duplicate funding and incidences where multiple bank drafts may have been printed to circumvent the \$500 limit.

The SARS report only provides information on bank draft activity for a specific month. For example, the March 2007 SARS report identified a total of 1,537 bank drafts printed for a total encumbrance of \$315,297. Since bank drafts may not be used/processed in the month issued, the total expended amount reported for the month was only \$65,547, leaving a remaining balance of \$249,750 in uncashed bank drafts. The April 2007 report only reflects April bank drafts encumbered and will not provide information on previous months activity.

Centralized Services and Information Systems Services (ISS) staff have also recognized the impact on monitoring of bank draft usage when information is only reported for the month in which the bank drafts were encumbered. As such, further efforts are being made to correct the problem.

Criteria:

Policies and procedures are identified in the State Administrative Manual (SAM), RAM, and Rehabilitation Directives and Memos for bank draft authorization, issuance, and monitoring.

An effective SARS report is an essential tool in ensuring compliance with current policies and procedures pertaining to authorizing, issuing, and monitoring bank drafts.

RECOMMENDATION:

Centralized Services continue its efforts to identify where improvements to the bank draft system and the SARS report can be made to ensure compliance with established policies and procedures.

CHAPTER 3: IMPROVEMENTS CAN BE MADE TO THE DEPARTMENT'S COLLECTION FUNCTION
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FINDING 1 COLLECTION PROCEDURES FOR EMPLOYEES ON MEDICAL LEAVE COULD BE IMPROVED

Condition:

We reviewed the Department's travel advances as of September 16, 2006. There were 31 advances outstanding totaling \$10,620 at the time of our review. We found that the collection of travel advances has improved over past years; however, we noted improvements can be made in regards to employees on medical leave.

Our review found that only 5 of 31 advances outstanding were past due. Collection efforts for 2 of the advances were found to be adequate and in accordance with collection procedures. However, for 3 of the 5 advances, we found that the advances were not cleared timely due to the Accounting Section's reliance on past information from Legal Affairs in regards to collection of monies owed from medical leave payments; and lack of information such as the employees return-to-work date or that the employee is supplementing their medical with sick, vacation, or other leave balances. As such, 2 advances were not cleared until 72 and 184 days after the due date; and 1 advance was not cleared for 1,187 days after the due date. Lack of timely collection of advances increases the risk of funds being uncollectible.

Audit Services contacted other State departments, and consulted with the Department's Legal Affairs, and concluded that the Department can collect monies owed by employees from medical leave/workers' compensation pay and supplementation pay issued to employees through the State Controller's Office (SCO) warrant.

Criteria:

State Administrative Manual (SAM) §8116.3 states that if an employee does not submit a Travel Expense Claim (TEC) to substantiate the travel expense within 30 calendar days of the periodic statement date, the total travel advance amount must be deducted from the next regular payroll warrant. If an employee does submit TECs within 30 calendar days of the periodic statement date, but does not return any excess travel advance amount within the same 30 calendar days, the excess travel advance amount must be deducted from the next regular payroll warrant.

RECOMMENDATION:

The Department establish specific procedures and written guidelines for clearing advances to employees on medical/workers compensation leave in compliance with SAM. Any warrant being issued by SCO to employees on medical leave shall be pulled to clear outstanding advances.

**FINDING 2 CONTROLS OVER CLEARING OF SALARY ADVANCES
NEED IMPROVEMENT**

Condition:

We reviewed the Department's salary advances as of August 15, 2006. There were 15 advances outstanding totaling \$23,963 at the time of our review.

Our review found that the salary advance clearing procedures for 11 of the advances were found to be adequate and in accordance with SAM. Salary advances are typically cleared when a corrected payroll warrant due to late dock, inaccurate attendance reporting, hardship, or employee separation, is issued by SCO for the related pay period. However, for 4 of the 15 advances, totaling \$6,385, we found that the advances were not cleared timely due to Departmental oversight. Lack of timely collection of advances increases the risk of funds becoming uncollectible.

- Two advances issued for late dock were not cleared timely since the warrants issued by SCO to clear the advances were released to the employees in error. Further, one of those employees received the warrant by direct deposit since proper procedures were not followed to cancel the direct deposit. As a result, the advances which should have cleared when the July 2006 pay warrants issued, were not cleared until November 2006.
- One advance issued for separation pay was not cleared with the related pay warrant. The warrant received to clear the advance was released and sent to the former employee in error. Proper procedures for clearing the salary advance were not followed. As such, this advance remains outstanding since March 2004 and it is likely to remain uncollectible.
- One advance issued for workers' compensation issues was not cleared timely since the warrant to clear the advance was released to the employee in error. The advance remains outstanding since November 2001 and the employee separated on December 1, 2001 without clearing the advance. The former employee was not notified of the outstanding

advance until January 2003. Proper procedures were not followed for clearing this advance and it is likely to remain uncollectible.

Criteria:

Departmental policy dated March 14, 1995 states that employees on direct deposit cannot be paid a salary advance unless Personnel is able to cancel the direct deposit before the end of the month cutoff.

SAM §8776.7, Employee Accounts Receivable, states that if the amount of the warrant is greater than the actual amount of pay owed the employee in the corresponding pay period, departments may withhold the employee's pay warrant and issue a revolving fund check for the difference.

SAM §8580.4 states that salary warrants will not be distributed to separating employees until the department has verified that all travel and salary advances have been paid and cleared. The verification must be provided by office revolving fund staff. If after separation the employee leaves owing the department monies, it is the responsibility of the department to pursue collections as described in SAM §8776.6.

Government Code 19838(b) states that an employee who is separated from employment prior to full repayment of an amount owed shall have withheld from any money owing the employee upon separation an amount sufficient to provide full repayment. If the amount of money owing upon separation is insufficient to provide full reimbursement to the state, the state shall have the right to exercise any and all other legal means to recover the additional amount owed.

RECOMMENDATION:

The Department ensure direct deposits are canceled appropriately and salary advances are cleared timely and do not become uncollectible. Improvements to the clearing of advances at the time of separation should be made.

**FINDING 3 GENERAL FUND ACCOUNTS RECEIVABLE
COLLECTION PROCEDURES COULD BE IMPROVED**

Condition:

As of July 31, 2006 a total of 40 invoices totaling \$338,537 were outstanding for the General Fund (GF)-Other Category Accounts Receivable. We selected a sample of 6 invoices, totaling \$57,252 for review and noted areas where improvements could be made.

- ***Collection Letters Are Not Sent Timely***

GF Accounts Receivable collection letters are not always being sent within the 30-day intervals required by SAM. As a result, collection efforts are delayed and the accounts receivable may become uncollectible. For 2 of the 4 invoices, Accounting staff explained that letters were not sent timely due to oversight. For 4 of the 6 invoices, Accounting staff could not explain why the letters were not sent timely as there has been staff turnover since that time.

- ***Lack of Follow-Up on Outstanding Collection Actions***

The Accounting Section does not follow-up on outstanding collection actions in timely manner. For example:

- An outstanding accounts receivable (due from a non-profit) of \$11,600 invoiced in 1995 still remains uncleared. The Accounting Section applied for discharge of accountability in October 1997; however the application was returned by SCO in December 1997 with questions and an opportunity for the Department to re-submit the application with the additional information requested. We found no evidence that any further actions were taken to re-submit the discharge to SCO and the monies remains outstanding.
- Another outstanding accounts receivable of \$32,238 invoiced in 1998 still remains uncleared. The accounts receivable was pending litigation with the General Services Administration (GSA). Comments were noted on the tracking spreadsheet from the Department's Chief Counsel in 2003 that stated 'need to send payment requests to GSA, as it is likely to be resolved this year'. However, no further follow-up was conducted by the Accounting Section to resolve this outstanding accounts receivable.

Criteria:

SAM §8776.6 states that each department will develop collection procedures that will assure prompt follow-up on receivables. Once the address of the debtor is known, the accounting office will send a sequence of three collections letters at 30-day intervals.

SAM §8776.6 requires that if the collection letters are unsuccessful, the department shall conduct a cost/benefit analysis of further collection efforts such as offset procedures, court settlements, collection agencies, and sale of accounts receivable. If all reasonable collection procedures do not result

in payment, department may request discharge from accountability of uncollectible amounts due from private entities. Departments will file an Application for Discharge from Accountability (STD27) with the SCO, Division of Collections.

RECOMMENDATION:

The Department review its procedures to ensure GF Accounts Receivable collection actions are performed in a timely manner in accordance with SAM including timely follow-up on pending discharges and other collection actions.

**FINDING 4 PAYROLL ACCOUNTS RECEIVABLE NEED
SIGNIFICANT IMPROVEMENT**

Condition:

As of July 31, 2006 a total of 232 payroll accounts receivable for over 90 employees totaling \$75,994 were outstanding. We selected a sample of 11 employees for review, totaling \$37,670, and noted areas where significant improvements are needed.

The Personnel Section is responsible for :

- ✓ The initial payroll accounts receivable notification (15-day letter), in writing, to employees and separated employees as soon as the accounts receivable is known.
- ✓ Establishing a repayment plan with the employee.
- ✓ Notifying SCO of the payroll adjustment.
- ✓ Ensuring collection of the overpayments prior to separation.

The Accounting Section is responsible for collection of overpayments after the employee separates.

• ***Initial Notification Not Timely***

Of 11 employees reviewed, we found the initial notification to 7 employees occurred between 34 to over 637 days after the SCO notice date. In addition, for one employee there were 28 payroll accounts receivable for the period of December 2003 through June 2004; however, as of July 31, 2006 an initial notification letter had not been sent by the Personnel Section.

By not notifying employees promptly of payroll accounts receivable, delays in collection efforts can occur and may result in those monies becoming uncollectible.

In addition, we found that the Accounting Section tracking spreadsheet listed over 30 employees for which an initial notification letter had not been received from the Personnel Section. Although we did not perform specific testing of these 30 accounts receivable, we wanted to bring this issue to management's attention so that notification processes can be improved.

- ***Notification of Employee Separation Appears Deficient***

Our review found several instances where employees separated from the Department with outstanding accounts receivables not being collected. Although policies and procedures exist for notification of employee separations, the Department continues to experience instances where outstanding monies owed are not collected at the time of separation. As such, it is likely that these monies will become uncollectible.

- ***Efforts to Resolve and Collect Need Improvement***

The Department has not made reasonable efforts to resolve and collect payroll accounts receivable past due for numerous years. For example, the following payroll accounts receivable were still outstanding as of July 2006:

	Outstanding Amount	SCO A/R Issue Date
Employee A	\$2,674	2003 and 2004
Employee B	\$7,586	2003
Employee C	\$6,575	2004
Employee D	\$6,994	1999
Employee E	\$8,442	2005
Total	\$32,271	

Personnel management staff stated that the reasons these accounts receivable remain outstanding include:

- ✓ Some are special cases which require more research and follow-up.
- ✓ Personnel Specialist did not follow procedures.
- ✓ Personnel Specialist turnover.
- ✓ Shift in unit priorities.

Although we recognize there may be contributing factors to the delay in collection efforts, progress is not being made over several years. Lack of timely action on monies owed may result in these monies becoming uncollectible. Adequate and timely follow up could resolve these outstanding accounts receivable in a more timely manner.

- ***Payroll Accounts Receivable Could be Reduced***

As of July 31, 2006, the Department's payroll accounts receivable totaled \$75,994 with \$66,846 (88%) being collected through agency collection and \$9,147 (12%) being collected through automatic payroll deduction. Further, as of August 31, 2007 the payroll accounts receivable outstanding totals \$133,483.

Although we did not perform specific testing, controls in this area should be reviewed to minimize payroll errors and ensure employees are complying with payment agreements. If employees do not repay as agreed upon, the Department should move to collect through automatic payroll deduction.

Although the Accounting Section has developed a tracking spreadsheet based on the SCO Notice of Payroll Accounts Receivable that is provided to the Personnel Section monthly, improvements to the tracking system are needed. Without adequate tracking of payroll accounts receivable, the Department cannot ensure adequate collection efforts are occurring; and determine where payroll errors are being made to improve internal processes.

Criteria:

SAM §8776.3 states that an invoice or other type of claim document will be prepared and sent out as soon as possible after the recognition of a claim.

Government Code §19838 requires reimbursement to the State of overpayments made to employees. This section states that when the State determines an overpayment has been made to the employee, it shall notify the employee of the overpayment and afford the employee an opportunity to respond prior to commencing recoupment actions. Thereafter, reimbursement shall be made to the State through one of the following methods mutually agreed to by the employee and the State: (1) cash payment or payments; (2) installments through payroll deduction. Absent mutual agreement on a method of reimbursement, the State shall proceed with recoupment via payroll deduction.

Government Code §19838(b) states that an employee who is separated from employment prior to full repayment of the amount owed shall have withheld from any money owing the employee upon separation an amount sufficient to provide full repayment. If the amount of money owing upon separation is insufficient to provide full reimbursement to the

State, the State shall have the right to exercise any and all other legal means to recover the additional amount owed.

Government Code §19838 (d) states that no administrative action shall be taken by the State pursuant to this section to recover an overpayment unless the action is initiated within three years from the date of overpayment.

SAM §8116.3 and 8776.7 detail the procedures and guidelines for the notification and collection of amounts owed to the State by employees. SAM 8776.6 discusses procedure to follow for non-employees.

RECOMMENDATION:

The Personnel Section ensure the initial payroll accounts receivable notification letters are sent out timely to the employee, with a copy to the Accounting Section. In addition, once a payment plan is agreed upon, the Accounting Section shall receive a copy of the signed plan for reference and monitoring purposes.

The Department review current employee separation notification procedures to identify where improvements can be made.

The Personnel and Accounting Sections' identify where improvements can be made. This should include:

- Identification of types of payroll errors and how errors can be minimized.
- Designation of Personnel Section staff person to oversee payroll accounts receivable collection efforts to ensure payment terms are being adhered to and to ensure appropriate actions are taken when employees fail to comply with payment terms; and to ensure collection efforts are timely and in compliance with requirements.
- Improved communication of collection efforts through monthly meetings between Personnel and Accounting.
- Consideration of one single tracking spreadsheet to be used by both units which includes more information about the account receivable and collection efforts such as beginning balance, payment, ending balance and repayment terms.
- Consider adding language to the initial notification which states that if the employee does not comply with the agreed upon repayment terms, the Department will collect through automatic payroll deduction from the next regular payroll warrant.

FINDING 5 BEP ACCOUNTS RECEIVABLE COLLECTION EFFORTS DO NOT COMPLY WITH SAM AND NEED IMPROVEMENT

Condition:

As of July 31, 2006, we found that 250 BEP Delinquent Invoices totaling \$322,932 remain outstanding. We selected a sample of 15 BEP vendors for review (8 active and 7 inactive), totaling \$136,684, and noted areas where improvements are needed.

SAM requires that each department develop collection procedures that will assure prompt follow-up on receivables. Once the address of the debtor is known, the Accounting office will send a sequence of three collection letters at 30-day intervals.

- ***Collection Letter Time Intervals Do Not Comply with SAM***

The Accounting Section's desk procedures do not comply with SAM since the time intervals for invoicing and sending collection letters to BEP vendors does not agree with the 30-day notification intervals required by SAM.

For example, in discussions with the Chief of Accounting, the Accounting Section's typical process at the time of our review was as follows:

- October MOR received 11/25/06
- Deposit released 12/13/06
- Adjustment Sheet sent 12/18/06
- Possible payment received 1/25/07 (with December MOR)
- No payment received by 2/28/07
- Invoiced 3/20/07 (1st Notice)
- 2nd Notice 5/20/07
- 3rd (Final) Notice 7/20/07

In addition, we found several instances where the 2nd and 3rd notices were not sent or not sent timely in accordance with the Accounting Section's established procedures. Accounting management stated that staff resource issues, delays in keying and releasing MORs, and notices which were overlooked by prior staff have caused delays in collection efforts.

In accordance with SAM, the adjustment sheet should be the invoice. After that, a series of collection letters must be sent at 30-day intervals. Inadequate collection procedures may result in these monies becoming uncollectible.

- ***Lack of Follow-Up on Outstanding Collection Actions***

The Accounting Section does not follow-up on outstanding collection actions in timely manner. Specifically, the Accounting Section did not take steps to adequately monitor the Discharge of Accountability applications submitted. We found one instance where the application was denied; and two instances where applications were still pending at SCO since March 2006 with no evidence of follow up by the Accounting Section.

Criteria:

SAM §8776.2 states that a valid accounts receivable is a receivable which is due and payable and for which there is no apparent disagreement over the validity of the claim or the amount at the time it was established. SAM §8776.3 states that an invoice or other type of claim document will be prepared and sent out as soon as possible after the recognition of a claim.

SAM §8776.6 requires departments to develop collection procedures that will assure prompt follow up on receivables from non-employees and include procedures and guidelines for the collection of amounts owed to the State. These procedures are in accordance with the Accounts Receivable Management Act as provided in Government Code §16580-16586.

SAM §8776.6 states that once the address of the debtor is known, the accounting office will send a sequence of three collections letters at 30-day intervals. SAM §8776.6 requires that if the collection letters are unsuccessful, the department shall conduct a cost/benefit analysis of further collection efforts such as offset procedures, court settlements, collection agencies, and sale of accounts receivable. If all reasonable collection procedures do not result in payment, department may request discharge from accountability of uncollectible amounts due from private entities. Departments will file an Application for Discharge from Accountability (STD27) with the SCO, Division of Collections.

RECOMMENDATION:

The Accounting Section review and revise its BEP Delinquent Invoice collection procedures to ensure compliance with SAM. This should include recognizing the adjustment sheet as the invoice and following up with collection notices at 30-day intervals. The timeframe for submission of the delinquent amounts should not be linked with submission of subsequent MORs as this delays the collection process.

We recommend the Accounting Section request BEP provide written notification to all vendors that when delinquent invoices are sent, monies

owed needs to be sent in immediately to the Accounting Section with a separate check, not sent in with the MORs.

The Accounting Section determine the necessary steps and timeline to monitor status of the Discharge of Accountability applications submitted to ensure the applications are processed in a timely manner. In addition, appropriate follow up actions must be taken when applications are denied.